92-1751

No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1992

ALCAN ALUMINUM CORPORATION,
Petitioner,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA IN AND FOR THE SECOND APPELLATE DISTRICT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the use of a three-factor formula generally referred to as worldwide combined reporting, which assigns a portion of the worldwide income of a group of companies headed by a non-United States domiciled foreign parent by comparing sales, payroll and property values in California with sales, payroll and property values around the world, violates the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3.

RULE 29.1 STATEMENT

Petitioner, Alcan Aluminum Corporation, is a wholly-owned subsidiary of Alcan Aluminium Limited, a corporation organized and existing under the laws of Canada.

Alcan Aluminum Corporation's subsidiaries include Alcan-Toyo America, Inc., Alcan Sumitomo Electric, Inc., Logan Aluminum, Inc., the Aluminum Railcar Company, Polyfiltronics N.A., Inc., Ampersand Corporate Spin-off Ventures and Lanxide Corporation.

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PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The Superior Court of California for the County of Los Angeles issued its Statement of Decision on September 30, 1991 entering judgment for Respondent Franchise Tax Board. That decision is reprinted in the Appendix at A10-A13.

The Court of Appeal of the State of California, Second Appellate District, Division Three, affirmed the lower court in an unreported decision issued on November 16, 1992, which is reprinted in the Appendix at A1-A8.

The California Supreme Court denied Petitioner's Petition for Review by Order dated February 11, 1993, which is reprinted in the Appendix at A9.

JURISDICTION

The Court of Appeal of the State of California, Second Appellate District, Division Three, affirmed the decision of the Superior Court for the County of Los Angeles on November 16, 1992.

Petitioner timely filed a Petition for Review in the Supreme Court of California on December 23, 1992. That Petition for Review was denied on February 11, 1993, thereby rendering final the decision of the Court of Appeal. Petitioner presently seeks review of those orders.

The jurisdiction of the Supreme Court of the United States is invoked pursuant to 28 U.S.C. §1257(a).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

United States Constitution, Article I, Section 8, Clause 3 (the Commerce Clause) provides that:

> [The Congress shall have Power] To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

California Revenue and Taxation Code §25101 states:

> §25101. Basis of allocation
>
> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120). However, any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not the transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.
>
> If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to it the basis upon which its reapportionment has been made.

California Revenue and Taxation Code §25137 states:

> §25137. Proceedings where allocation and apportionment provision fail to fairly represent taxpayer's business activity in state
>
> If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the

taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

STATEMENT OF THE CASE

This is an action seeking the refund of franchise taxes paid to the State of California during the years 1965 through 1971. The franchise tax was computed by the unitary or formulary method of taxation, also referred to as worldwide combined reporting ("WWCR"), applied to a non-domiciled foreign parent combination. It is Petitioner Alcan Aluminum Corporation's ("Alcan") contention that such a tax violates the foreign Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3. Alcan is a wholly owned subsidiary of Alcan Aluminium Limited ("Limited"), which is a corporation organized and existing under the laws of Canada. Limited's headquarters and principal place of business are in Montreal, Quebec, Canada. Limited and various of its subsidiaries are engaged in all phases of the aluminum business on an international scale. Neither Limited nor its non-United States subsidiaries have a permanent establishment in the United States.

Alcan, the Petitioner in this case, was at the time in question a corporation organized and existing under the laws of the State of New York with its principal place of business in Cleveland, Ohio. Alcan and its subsidiaries are engaged in the business of fabricating and selling various aluminum products in the United States. Certain activities of Alcan are conducted in the State of California.

The Respondent in this case is the Franchise Tax Board of the State of California ("FTB"). Since 1965, the FTB has assessed franchise taxes on Alcan for doing business in the State of California on what is known as a "unitary" basis. Under this method of taxation, the income of the unitary business attributable to California is calculated by a three-factor formula which multiplies

the total worldwide income of Limited by the relative percentage of that business' property, payroll and sales in California.

The result of WWCR is that FTB has measured and assessed franchise taxes not solely on the income of Alcan and its United States affiliates, but also on the worldwide income of Limited and all of Limited's non-United States subsidiaries (the "Alcan Unitary Business"). The purpose and effect of the Respondent's actions are to greatly inflate the amount of tax assessed and collected by attributing to California a portion of the worldwide income of Limited and its non-United States subsidiaries all of whom have no permanent place of business in the United States and all of their income is subject to the tax rules of the host country in which they conducted business and in Canada upon distribution.

The effect of this taxation is to tax the income of Limited and its non-United States subsidiaries multiple times and effectively to tax Limited's non-United States foreign operations. In addition, it has the potential to impose substantial costs of compliance upon Limited and its non-United States subsidiaries. The existence of multiple taxation and the absence of a sufficient nexus upon which to predicate a tax on activities that take place exclusively in foreign commerce, as well as the discriminatory impact of the compliance burden, constitute a violation of the foreign Commerce Clause. Finally, because of the foregoing and because of the international understanding that the taxation of foreign subsidiaries must be done exclusively on an arm's length/separate accounting ("AL/SA") basis, the Respondent's method of taxation interferes with the foreign policy of the United States and its ability to "speak with one voice," again violating the foreign Commerce Clause of the United States Constitution.

In 1984, Limited commenced an action in the Federal District Court for the Northern District of Illinois. The purpose of that action was to seek an injunction and declaratory judgment that the present tax violated the foreign Commerce Clause of the United States Constitution. This case was held in abeyance by agreement between the parties pending the resolution of the federal action. In 1990, this Court rendered an Opinion that held that the federal action was tentatively barred by the Tax Injunction Act on the presumption that Alcan could raise and have adjudicated in its refund action in the California courts all of the injuries to Limited. *Franchise Tax Board v. Alcan Aluminium, Ltd.*, 493 U.S. 331 (1990). As a result of that ruling by this Court, the present case proceeded.

Alcan raises essentially the same constitutional issues in this case that Limited had raised in the federal action. The parties filed cross motions for summary judgment based on stipulations of fact. The Los Angeles County Superior Court entered judgment for FTB and Alcan appealed. The Second Appellate District, Division Three of the Court of Appeals of the State of California affirmed the trial court on November 16, 1992. Alcan duly filed its Petition for Review with the California Supreme Court on December 23, 1992. That Petition for Review was denied on February 11, 1993. Alcan now seeks to have this Honorable Court grant its Petition for a Writ of Certiorari so that this Court may address the essential constitutional issues raised by this appeal.

THE PROCEEDINGS BELOW

A. The Federal Question Raised In This Case

In Petitioner's pleadings and briefs in the California Superior Court for the County of Los Angeles, in its Briefs in the California Court of Appeal, Second Appellate District, Division Three, and in its Petition for Review to the California Supreme Court, Alcan contended that the Respondent's use of WWCR as applied to a non-domiciled foreign parent combination violated the Commerce Clause of the United States Constitution.

B. The Decisions Below

1. *The California Superior Court for the County of Los Angeles*

The Los Angeles Superior Court entered judgment for Respondent relying on this Court's reasoning in *Wardair Canada v. Florida Department of Revenue,* 447 U.S. 1 (1986), which held that there was no need for the Court to undertake a dormant commerce clause analysis since "having failed to preclude the States' use of [WWCR], Congress has, by clear negative implication, authorized its use by the states." A11.

Further, the Los Angeles Superior Court cited the decision of the California Court of Appeal for the Third Appellate District in *Barclays Bank International, Ltd. v. Franchise Tax Board,* 275 Cal. Rptr. 626 (1990), which held that the use of WWCR is unconstitutional under the dormant commerce clause analysis as set out in *Japan Line Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979) A11. The Los Angeles Superior Court, however, stated that "[t]aken together the five factors advanced in *Barclays Bank* demonstrate a legislative intent on the

part of Congress not to restrict the states' use of [WWCR]. The same factors are urged here and the presence of the fifth presents an *a fortiori* case to *Wardair* itself." A12,A13.

The Los Angeles Superior Court concluded that "the facts presented here do not present any case specific circumstances that differentiate this action from *Barclays Bank* or the [Alcan] action in the Sacramento Superior Court, as far as the application of the dormant commerce clause constitutionality analysis versus the reasoning of *Wardair* is concerned, and the determination forthcoming in the [California] Supreme Court [in the *Barclays* case] will, in all likelihood, be dispositive in this action upon appellate review." A13.

2. ***The California Court of Appeal, Second Appellate District***

The Court of Appeal affirmed the decision of the Los Angeles Superior Court relying on the California Supreme Court's opinion in *Barclays Bank International Ltd. v. Franchise Tax Board*, 829 P.2d 279 (1992), *cert. denied, Barclays Bank PLC v. Franchise Tax Board*, _____ U.S. _____, 113 S. Ct. 202 (1992),[1] which held that a "dormant commerce clause analysis is not appropriate where the federal government has acted in

[1] The California Supreme Court remanded the *Barclays* case to the Court of Appeal on the issue of the discriminatory effect of the compliance burdens on the Commerce Clause and the due process issue. While the remand was pending, Barclays sought review by this Court. That Petition was denied on October 5, 1992. The Court of Appeal rendered its decision on remand on November 20, 1992 and denied a Petition for Rehearing on December 18, 1992. The California Supreme Court denied a Petition for Review on February 18, 1993. Barclays has since filed a Petition for Writ of Certiorari to this Court, which is pending.

such a manner as to acquiesce in the states' use of worldwide formula apportionment." A5. Quoting *Barclays*, 829 P.2d at 294, the Court of Appeal stated:

> In our view, Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind. To paraphrase the *Wardair* [*Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1] opinion, international agreements demonstrate that the federal government has affirmatively acted, rather than remained silent, with respect to the power for the states to employ formula apportionment in so-called foreign parent cases; as a result, this case does not call for dormant foreign commerce clause analysis at all. [Citation.]

A5.

The Court of Appeal further stated that "[t]he *Barclays* Court rejected the sort of material claimed by [Alcan] and by *amici curiae* on its behalf, to evidence a 'clear federal directive' sustaining its dormant commerce clause case." A7. Again quoting *Barclays*, 829 P.2d at 295, the Court of Appeal found that "[r]ather than qualifying as a 'clear federal directive,' these materials, in the context of Congress's [sic] persistent refusal to regulate state taxation of multinationals and the Senate's explicit rejection of article 9(4) of the United States-United Kingdom treaty, embody nothing more than executive aspirations of what the federal government's policy in this area *ought* to be." A7.

The Court of Appeal also rejected the application of this Court's ruling in *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, _____ U.S. _____, 112 S. Ct. 2365 (1992) holding that the decision "has nothing to do with the question whether the dormant

foreign commerce clause precludes imposition by a state of a unitary tax based on the worldwide income of a multinational corporate taxpayer." A8.

3. *The Supreme Court of California*

Alcan filed a Petition for Review in the Supreme Court of California on December 23, 1992, which was denied without opinion on February 11, 1993, thereby rendering final the decision of the Court of Appeal in favor of Respondent, Franchise Tax Board.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

I. INTRODUCTION.

The utilization of the unitary method of taxation has been a matter of international controversy since it was adopted and applied by California over a quarter of a century ago. This Court reviewed the application of this tax to domestic parent combinations in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). In that case, this Court explicitly excepted from its holding the question of whether the tax was unconstitutional as applied to foreign parent combinations. As a practical matter, a final resolution of this controversy has awaited a determinative statement by this Court concerning the constitutionality of this method of taxation. This case presents the opportunity to address this issue *both* with respect to whether the tax creates a substantial risk of multiple taxation and whether the tax prevents the Federal Government from "speaking with one voice"as outlined by this Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), as well as whether this tax conflicts with the constitutional standards of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

II. PETITIONER'S WRIT SHOULD BE GRANTED BECAUSE THIS CASE PRESENTS FAR MORE ISSUES UNDER THE FOREIGN COMMERCE CLAUSE THAN WERE CONSIDERED BY THE CALIFORNIA SUPREME COURT IN *BARCLAYS BANK INTERNATIONAL, LTD. V. FRANCHISE TAX BOARD.*

In *Wardair Canada v. Florida Department of Revenue,* this Court noted that there were six critical questions in determining whether or not there was a violation of the foreign Commerce Clause:

> When a state tax is challenged as violative of the dormant Interstate Commerce Clause, we have asked four questions: is the tax applied to an activity with a substantial nexus with the taxing State; is the tax fairly apportioned; does the tax discriminate against interstate commerce; and is the tax fairly related to the services provided by the State. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977). In *Japan Line,* [441 U.S. 434, 451 (1978)], we noted that when the state tax allegedly interferes with the Federal Government's authority to regulate foreign commerce, two additional questions must be asked: "first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments."

477 U.S. 1, 8 (1986).

In *Barclays Bank International Ltd. v. Franchise Tax Board,* 829 P.2d 279 (1992), *cert. denied, Barclays Bank PLC v. Franchise Tax Board,* _____ U.S. _____, 113 S. Ct. 202 (1992), the California Supreme Court resolved the constitutional question by looking at

essentially one issue, the "speaking with one voice" aspect of this six part test. This resulted from the fact that the Bank was simply unable to present a factual context that was capable of demonstrating that WWCR offended numerous other elements of the six part test. By relying inappropriately on this Court's logic in *Wardair*, the *Barclays'* Court reasoned tautologically that Congress had approved the tax which thereby precluded Alcan from demonstrating that numerous other parameters in a complete Commerce Clause analysis were offended by the tax as it applied to Alcan. The Second Appellate Department reasoned in this respect:

> Alcancorp urges application of the dormant foreign commerce doctrine to the facts of this case. Under this doctrine, state action affecting interstate and foreign commerce may be limited even where Congress has failed to exert its plenary commerce clause power.
>
> *Barclays* . . . held dormant commerce clause analysis is not appropriate where the federal government has acted in such a manner as to acquiesce in the states' use of worldwide formula apportionment.

Alcan Aluminum Corp. v. Franchise Tax Board, No. B065648, slip op. at 5-6 (Court of Appeal of the State of California, Second Appellate District, Division Three, Nov. 16, 1992) (citations omitted) A4, A5. As Petitioner will demonstrate, the *Barclays* Court improperly reasoned from *Wardair* the result of which was to again deny Alcan the opportunity to present the factual context of its case which has been pursued by it and its parent, Limited, through the courts for over a decade.

A. The California Supreme Court Incorrectly Presumed That Because *Barclays Bank* Did Not Have A Factual Scenario That Demonstrated An Enhanced Risk Of Multiple Taxation That It Could Never Be Demonstrated.

The California Supreme Court in *Barclays* began its analysis by extrapolating from the reasoning of this Court and concluding that separate accounting could not, standing alone, impeach the use of the formulary method's accuracy in determining the tax. This Court has evolved a doctrine that makes it exceedingly difficult to demonstrate the existence of multiple taxation as a result of the use of WWCR. This does not mean that multiple taxation does not occur, nor that it is not massive in its impact. The problem results from the fact that this Court's logic is somewhat circular. If this Court fails to grant certiorari in this case, it will have precluded Alcan and presumably other foreign nationals from demonstrating the existence of multiple taxation as a result of WWCR simply because Barclays Bank, through no fault of its own, failed to do so.

The California Supreme Court in *Barclays* concedes that the unitary method of taxation can be constitutionally impeached if it can be shown that it "produce[s] an unreasonable result." 829 P.2d at 284 (quoting *Bass v. Tax Comm.*, 266 U.S. 271, 282-283 (1924)). The Court goes on to note that either AL/SA or WWCR is constitutionally permissible "as long as the [method] chosen does not operate 'unreasonably and arbitrarily' to attribute to the taxing state a percentage of total income 'out of all proportion to the business transacted by the [taxpayer] in that State.' " 829 P.2d at 285 (quoting *Hans Rees' Sons v. North Carolina*, 283 U.S. 123, 135 (1931)). However, after concluding that

Barclays failed to meet its burden in this respect, the California Supreme Court undertook to develop a doctrine that would effectively preclude every challenge to the tax regardless of the quality of the facts and the unreasonable and arbitrary nature of the tax by developing a doctrine that precludes consideration of the impact.

B. The Hallmark Of The Alcan Case Is That It Has The Factual Basis To Illustrate The Unreasonable And Arbitrary Nature Of WWCR Because It Can Convincingly Demonstrate That The Tax Assessed Against It Was Out Of All Proportion To Its Business In The State.

There is a simple reason why the AL/SA standard is the international standard. Since it is a market based standard, albeit not perfect, it is immune from the systematic manipulation of the party who stands to benefit from the formula's application. From the perspective of a multinational, Limited would have no objection to the use of a formula provided there was one agreed upon by all nations. The reason there is no agreement on a formula is because in the international context there are such great variations in economic systems and accounting standards that nations are unable to agree upon one. In a sense, the AL/SA standard has become the standard by default. The California Supreme Court took great pains to survey the history of this Court's comments on the legal equivalence of AL/SA with the formulary method. However, it was equally careful to articulate a doctrine which insures that contrary facts that might question the constitutional validity of WWCR in the foreign context, notwithstanding the fact that this Court reached its conclusions exclusively in the context of United States businesses, could never be considered.

Under the *Barclays* circumstances, it was impossible to demonstrate the extreme potential for massive double taxation for two reasons. First, *Barclays* had only a small portion of its potential WWCR liability at stake in the years at issue. Second, since separate accounting had been impugned as a basis for impeaching the unitary method, it left only rare instances in which the real economic impact of the tax might be demonstrated. The Alcan case presents just such an instance where the conclusion that WWCR was clearly taxing foreign income is inescapable. It was rare because the business operation had to be effectively destroyed in order to make the point. These facts present not only an opportunity for this Court to view in real economic terms the fundamental basis for the international objections to the tax, but also present this Court with an opportunity to reevaluate the limitations it has imposed on challenges to these taxes, and to develop a more realistic and fair standard for challenging such formulas in the foreign context.

The problem with the present state of the law with respect to impeaching formulas is that this Court does not present an objective standard upon which to evaluate a formula's fairness. The problem arises because this Court starts its reasoning with the proposition that formulas are justified because separate accounting permits companies to shift "undetectable"[2] sources of income in a manner that avoids taxation. However, as Sigmund Freud noted with respect to religion, this reasoning has the characteristics of being incapable of being proven or refuted:

---

[2] If these values were detectable and quantifiable, AL/SA could not be impeached since these values could simply be used to adjust the AL/SA result.

> Of the reality value of most of [religious beliefs] we cannot judge; just as they cannot be proved, so they cannot be refuted.

S. Freud, *Future of An Illusion*, 31 (1961).

The result is that the primary method for criticizing formula apportionment, separate accounting, becomes virtually useless because no matter how dramatic the difference between the AL/SA method and the WWCR method, the AL/SA method is suspect on the grounds that it is not accurately reflecting income since hidden values are escaping detection. This Court has reasoned in this vein in the past when it rejected an attack on a distorted formulary result. It concluded that since it had approved the formulary apportionment method because it believed that AL/SA missed significant but "unidentifiable" value, any distortion revealed by the AL/SA method must be suspect:

> In these circumstances [a unitary business], the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 438 (1980) (citing *Butler Bros. v. McColgan*, 315 U.S. 501, 508-509 (1942)).

Although it is true that a separate accounting method may not accurately measure these factors, it is equally true that it may. Since the present doctrine that this Court has adopted simply assumes that separate accounting never accurately measures these factors, any attempt to use it to impeach a formulary method is almost always destined for failure at the outset. This

case, however, presents a rare set of facts which shows the distorting effect of WWCR without reliance on AL/SA.

Alcan's franchise tax liability for the years in question arose primarily from the Riverside, California manufacturing operation. Alcan acquired the facility in 1965, along with assets in New York and New Jersey when it was formed by Limited. The Riverside facility was acquired from National Distillers and Chemical Corporation. At the time of its acquisition, the operation had been losing money on a separate accounting basis and was sold to Alcan at a market price that reflected that fact.

Alcan had great hopes that it could revive the facility and that it could be made profitable as a result of the expertise developed in the international sales and marketing operation of Limited.[3] Those hopes proved to be illusory. The facility continued to lose money as part of the Alcan operation and was finally closed in 1977. The Riverside facility was unquestionably an unprofitable operation in large measure due to its structure and organization. Early in Alcan's ownership, the United States Justice Department had concluded that Alcan's ownership of the Riverside facility raised antitrust concerns. The matter was resolved when Alcan entered into a consent decree to sell the facility. All of these events combined to independently confirm what the AL/SA numbers had, in fact, accurately represented as the actual economic status of Alcan's Riverside facility: California's formula was taxing the facility "out of all appropriate proportion to the business transacted . . . in that State." *Barclays*, 829 P.2d at 285 (quoting *Moorman Mfg. v. Bair*, 437 U.S. 267, 274 (1978)).

[3] This was, in a sense, a unitary operation in reverse where the California operation was to benefit from activities in other countries.

Alcan's attempts to sell the facility as required by the consent decree proved futile. It soon became apparent that the facility had no going concern value; that is the value which reflects the facility's ability to produce income. After making numerous efforts to sell the facility or make it profitable, Alcan management finally had to acknowledge that the facilities were simply incompatible with the reality of the contemporary marketplace. Managements' conclusions in this regard were recorded in the mid 1970's in the Request For Authorization to scrap the facility referred to in paragraph 14 of the Stipulation of Facts (Exhibit XXI):

> The Riverside sheet products operation has lost money in every year since 1972, averaging some $900,000 of loss before interest and tax per year during the last four years.
>
> The current Annual Plan predicts a loss of $1.3 million in 1976 and a further loss of $0.7 million next year (after interest but before tax). Sales and booking volumes are running about 10% under plan levels so a substantial additional loss, perhaps up to $0.2 million, can be anticipated . . .
>
> * * *
>
> With a few exceptions, the Riverside equipment is narrow and obsolete. Due to the growth pattern of the facility, the layout is inefficient and the "wide" casting and hot rolling line is too narrow even for double width siding. Any modernization program to increase width capabilities beyond 26" would have to embrace almost the entire plant and would probably cost as much as or more than starting on a green fields basis. The California market would not justify this sort of expenditure.

Stipulation of Facts, Exhibit XXI, *Alcan Aluminum Corp. v. Franchise Tax Board*, No. C-196604 (Cal. Sup. Ct., County of Los Angeles, Sept. 30, 1991) A14, A15.

The theory of unitary taxation is that unitary businesses shift income in a way that does not accurately reflect the real earnings in the state. However, the foregoing example demonstrates the dramatic failure of that theory when applied in the context of a foreign parent combination. It is absolutely clear that both the independent market place and the company recognized that the facility was not profitable because it was "obsolete". It was also well understood that the nature of the California market made any additional investment uneconomical. Given these facts, it is patently clear that California's economic climate and the physical state of the facility made it impossible for the Riverside facility to ever operate in a fashion that would result in overall profitability. In fact, that is precisely what the separate accounting numbers demonstrated. The formulary method, however, treated the facility as though it was highly profitable when it was, in fact, clearly losing money.

If Alcan had not been under an obligation to put the property on the market, the evidence that it had no going concern value independent of AL/SA, would not have been available. If the facility had not in fact been unprofitable, but instead had produced a reasonable income, just not nearly as much as the formulary method attributed to it, then Alcan would not have closed the facility. Under these circumstances and under the California Supreme Court's interpretation of this Court's reasoning, there would have been no basis to impeach the formulary method, even though the distorting effects of the tax might even have been more severe. Thus, in *Barclays*, when the Bank was unable to demonstrate that the tax was excessive when related to its activities in California, it was not because that was not true, but

simply because, through no fault of its own, it did not have the facts that Alcan had experienced through a series of different events.

Not only does this case present the facts that highlight the real impact of WWCR, but it also demonstrates that the formula-generated tax is being imposed upon income generated wholly outside the United States, which was already subject to taxation by the nation in which it was earned.

C. This Case Also Demonstrates Why AL/SA And WWCR Are Not Substantive Equivalents Simply Because Neither Are Perfect.

The California Supreme Court in *Barclays* lifted this Court's statements from *Container Corp.* to conclude that since both AL/SA and WWCR could result in double taxation, the two methods are substantively interchangeable in all situations:

> The court [this Court] first noted that 'allocating income among various jurisdictions bears some resemblance . . . to slicing a shadow,' and concluded that 'it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation [i.e., formula apportionment] in favor of another method [i.e., AL/SA] that also sometimes results in double taxation.'

Barclays, 829 P.2d at 288 (citing *Container Corp.*, 463 U.S. at 192-193).

This reasoning is flawed. There is very little in life that operates perfectly in practice; however, there are very significant distinctions that can be made on the underlying theory and the empirical evidence that supports a particular allocation scheme. For example, as

an economic issue there is no fundamental economic difference between *Container Corp.* and *Mobil Oil.* Both involved the allocation of United States value. The fact that the foreign dividends in *Container Corp.* had not been repatriated as an accounting event does not change the fundamental economic nature of the case since the value of those dividends was immediately reflected in the increased net worth of the parent, Container Corporation. Thus, the substantive equivalence of the formulary method and the AL/SA method in *Container Corp.* was in the context of a single United States economic climate to which both methods had demonstrated a reasonable empirical and theoretical relevance. What the Riverside example illustrates is what occurs when WWCR is applied in a context where the formula has not been demonstrated to have the same relevance in terms of how income is generated among widely varied economic cultures. Clearly, the more socialistic the system, the less relevant payroll becomes in reflecting profit generation.

AL/SA is imprecise in its allocation of income between nations but that imprecision stems from the imperfection in measurement not the irrelevance of the allocation scheme. The California Supreme Court treats measurement imperfection as the substantive equivalent of a method of allocation for legal purposes and that, in our view, is both a legal and common sense mistake.

The fallacy in the California Supreme Court's logic might be illustrated by reference to the physical sciences. High school and college physics courses teach that there are two well-known methods of explaining how matter behaves. On the macro-level, there are the well-known principles of Newtonian mechanics. At the subatomic particle level, however, there are principles referred to as Quantum mechanics. Even though both disciplines are

relationships between the same matter, the principles of each discipline are distinctly different. These principles are expressed by formulas similar in kind to apportionment formulas.

In measuring physical events in both macro and subatomic levels, the instrumentation is by its nature inaccurate. Obviously, improvements have taken place over time, but nothing is perfect. However, it would be highly inappropriate to use a Newtonian formula to explain a subatomic event simply because the instrumentation is inaccurate. Quantum mechanics was developed because it became clear by empirical investigation that Newtonian mechanics did not explain subatomic events even if there might be some superficial similarity. Thus, a formula which explains what happens with the cue ball on a billard table on the break shot of a game, is not appropriate for explaining what happens when protons are accelerated into an atomic nucleus.

Similarly, from an economic perspective, a formula which relies on wage rates, capital (property) costs and the market value of sales in a third world country where labor is very cheap and used instead of capital and the cost of living is very low, will have equally as little relevance to how profits are generated as the cue ball formula does to the atomic nucleus. The Riverside example illustrates these facts.

D. Petitioner's Writ Of Certiorari Should Be Granted Because The California Supreme Court Clearly Misunderstood This Court's Reasoning In *Wardair Canada V. Florida Department Of Revenue* And Precluded Alcan From Ever Presenting Its Evidence Of Multiple Taxation.

It has been the hallmark of Alcan's case that the WWCR violates the Commerce Clause because it offends the principles that this Court has enunciated in *Complete Auto* and *Japan Line.* This case presents the factual context to illustrate that fact. The California Supreme Court has refused to consider Alcan's facts because it held, in effect, that since Congress failed to explicitly prohibit that which might otherwise be prohibited as a matter of law, Congress really has permitted the activity. This peculiar logic is predicated on a clear misreading of *Wardair.* In *Wardair*, this Court did not conclude that a dormant Commerce Clause analysis was not appropriate because Congress had acted to permit the tax. Rather, this Court concluded that the case was not appropriate for a dormant Commerce Clause analysis because both of the parties agreed that none of the elements for such an analysis existed:

> In the present case, appellant concedes that Florida's tax satisfies the four-part test set out in *Complete Auto.* In other words, it is not disputed that if this case did not involve foreign commerce, the Florida tax on the sale of aviation fuel would not contravene the Commerce Clause. Appellant also recognizes that there is no threat of multiple international taxation in this case, since the tax is imposed only upon the sale of fuel, a discrete transaction which occurs within one national jurisdiction only. Appellant and the United States as *amicus curiae* thus rely entirely on the final factor identified in *Japan Line,* and argue that the

> Florida tax violates the Foreign Commerce Clause because it threatens the ability of the Federal Government to 'speak with one voice.'

Wardair, 477 U.S. at 8-9.

It is one thing to say that an otherwise completely constitutional tax is not unconstitutional because the federal government has not acted in a way that convincingly suggests that the tax interferes with its foreign relations, and even appears to countenance the tax by a failure to prohibit it. That is essentially a proof issue and this Court concluded that *Wardair* failed to meet its burden to establish a federal policy. It is quite another thing, however, to suggest that the failure of the federal government to act to prohibit a tax that is otherwise illegal because it offends the elements of *Complete Auto* can be converted to the legal equivalent of a statutory expression by the Congress and the Executive that the tax has been authorized. That is precisely what the California Supreme Court did in *Barclays* and this Court should review its action for two reasons. First, it clearly conflicts with this Court's explicit requirement that Congress may only permit activities that would otherwise offend the Commerce Clause by explicit statutory action even when it appears to be consistent with United States policy. In reviewing an Iowa unitary tax scheme which discriminated against foreign commerce by including foreign dividends in the tax base and not including dividends from United States subsidiaries, this Court held that absent explicit statutory authorization, the tax cannot avoid a Commerce Clause analysis even if it is otherwise consistent with United States policy:

> Iowa need not adopt the federal definition of taxable income. Nor, having chosen to follow the federal system in part, must Iowa duplicate that scheme in

> all respects. The adoption of the federal system in whole or in part, however, cannot shield a state tax statute from Commerce Clause scrutiny. The Iowa statute cannot withstand the scrutiny, for it facially discriminates against foreign commerce and therefore violates the Foreign Commerce Clause.

Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin., _____ U.S. _____, 112 S. Ct. 2365, 2372 (1992).

Second, the California Supreme Court's decision sets a dangerous precedent because it permits courts to insert their judgments as to why Congress did not act and convert that judgment to the equivalent of legislation. This is not only judicial legislation in its grossest form, it takes the entire notion of courts usurping the role of the legislature a step further by permitting a state court to elevate its judgment to legal equivalent of a federal statute.

III. THE CALIFORNIA SUPREME COURT'S CONCLUSION THAT THERE IS A FEDERAL POLICY PERMITTING THE TAX IS NOT SUPPORTED BY THE OVERWHELMING EVIDENCE.

It should be clear to this Court from the foregoing that AL/SA, which this Court acknowledged in *Container Corp.*, is the international standard. That is not as much a matter of choice as it is of necessity. Since nations are unable to agree on a formula, the AL/SA method which relies on the market place as the ultimate arbiter of where profits are earned becomes the policy of nations by default as well as by choice. The lower courts in these cases have had numerous nations, including the United States, appear before them in both the *Alcan* and *Barclays* cases and insist that their common understanding of United States policy is that federal taxation of subsidiaries of foreign nations must be limited to the AL/SA standard.

The California Supreme Court's conclusion in *Barclays* that Congress' failure to explicitly prohibit the tax means Congress intended to approve it, is flawed. There are numerous other more plausible explanations for congressional inaction. One of the most obvious is that there is no need to prohibit that which is already illegal. The federal government's explicit statement of intent to pursue the matter through the courts certainly supports that view. *See* Joint Report by Inland Revenue and U.S. Treasury, Unitary Tax, December, 1991 Report, reprinted in Appendix at A17-A37.

The facts do not support the position of the California Supreme Court that the failure of article 9(4) of the United States-United Kingdom treaty indicates that Congress intended to permit the tax. *See Barclays,*

829 P.2d at 294. It is quite clear that there were never enough votes to pass a statutory authorization for the tax as illustrated by the small margin by which the treaty provision failed to get the required two-thirds vote. Moreover, the California Supreme Court tragically misinterprets the restrained attempts by the federal government to persuade California to get in line with the international community as a sign that the tax is condoned. The California Supreme Court seems to be saying that all they respond to is force.

Finally, the California Supreme Court's reliance on *Wardair* is misplaced. In that case, it was clear that the tax involved was a perfectly appropriate tax absent a clear and explicit preclusion by federal action. These facts are dramatically different. Here it is clear that foreign income is pulled into the California tax base to determine the California liability. The unitary tax theory is not limited to taxing a discrete event in the state, but determining the liability of the entire international business to California. Under the circumstances there is no support for the notion that California's characterization of federal policy is correct.

CONCLUSION

For all of the foregoing reasons, Alcan respectfully requests that this Honorable Court issue a Writ of Certiorari to the Court of Appeal of the State of California in and for the Second Appellate District.

Respectfully submitted,

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APPENDIX

OPINION OF THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT, DIVISION THREE

(Filed November 16, 1992)

NOT TO BE PUBLISHED

B065648
(Super.Ct.No.C196604)

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION THREE

ALCAN ALUMINUM CORPORATION,
Plaintiff and Appellant,

v.

FRANCHISE TAX BOARD OF THE
STATE OF CALIFORNIA,
Defendant and Respondent.

APPEAL from a judgment of the Superior Court of Los Angeles County. Kurt J. Lewin, Judge. Affirmed.

Patricia Shuler Schimbor, Salvador A. Casente, Jr., William D. Rauch, Jr., and Hancock, Rothert & Bunshoft for Plaintiff and Appellant.

F. Eugene Wirwahn, Gene R. Gambale, and Arter, Hadden, Lawler, Felix & Hall for Amicus Curiae on behalf of Plaintiff and Appellant.

James A. Bruton, Acting Assistant Attorney General, Gary R. Allen, David English Carmack, John J. McCarthy and Lourdes G. Baird, United States Attorney, for Amicus Curiae on behalf of Plaintiff and Appellant.

Daniel E. Lungren, Attorney General of the State of California, Timothy G. Laddish, Senior Assistant Attorney General, Edmond B. Mamer, Superivising Deputy Attorney General, Philip C. Griffin, Deputy Attorney General, for Defendant and Respondent.

INTRODUCTION

Plaintiff taxpayer Alcan Aluminum Corporation (Alcancorp) brought this refund action to recover assessments totalling $1,720,615.94 levied against it by the Franchise Tax Board for the 1965 through 1971 tax years.

Following a bench trial on stipulated facts and issues, the superior court ruled in favor of the Franchise Tax Board. Alcancorp appeals.

ISSUE

The sole issue presented by this appeal is whether the Franchise Tax Board (Board) properly may measure the unitary tax (Rev. & Tax. Code, §25101 et seq.)[1]

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[1] Revenue and Taxation Code section 25101 provides in part: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120)."

(Footnote continued on following page.)

imposed upon Alcancorp, a New York corporation having its principal place of business in Ohio, based on the worldwide income of Alcancorp's parent, Alcan Aluminum [sic] Limited (Aluminium), a Canadian corporation headquartered in Montreal, and all of its subsidiaries, including non-United States subsidiaries.[2]

DISCUSSION

The issue was determined in the Board's favor in the very recent decision of our Supreme Court in *Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.* (1992) 2 Cal.4th 708.

1. *Unitary Taxation*

In *Barclay's, supra*, the court explained that the " 'three-factor' " model employed by the Board "defines the multijurisdictional scope of the unitary enterprise of which the taxable intrastate activities are a part, calculates the combined income of the components of the

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(Footnote continued from preceding page.)

"Section 25120 et seq. of the Revenue and Taxation Code is California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA; see 7A West's U. Laws Ann. (1985) p. 331); . . . the statute authorizes the use of a three-factor formula to apportion the net income from a taxpayer's total business activities in order to determine the net income attributable to intrastate activities. (. . .; Rev. & Tax. Code, §§25120-25140.)" (*Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.* (1992) 2 Cal.4th 708, 713, fn. 1.)

[2] Alcancorp also challenges the propriety of the unitary method of accounting on due process grounds, claiming compliance would impose an undue administrative burden on Aluminum [sic]. This ground was waived by Alcancorp's stipulation in the trial court: "For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or contending that the tax assessed violated the Due Process Clauses of the United States Constitution or the California Constitution."

unitary group, and distributes a portion of that result to the taxing state using a mathematical formula based on an averaged ratio of property, payroll, and sales in the taxing jurisdiction to that of the unitary enterprise overall. [Citation.]" (*Id.*, at p. 715, fn. omitted.)

"So far as taxation of United States-derived income is concerned, the use of formula apportionment is both established and noncontroversial, being the preferred method of a majority of the states; a substantially smaller number of American jurisdictions—California among them—combine and apportion the *worldwide* income of multinational corporate taxpayers, a variant sometimes referred to as the 'worldwide combined reporting' or 'WWCR' method." (*Id.*, at pp. 715-716, fn. omitted.)

2. *The Doctrine Of The "Unexercised," "Negative," Or "Dormant" Foreign Commerce Clause*

Alcancorp urges application of the dormant foreign commerce clause doctrine to the facts of this case. Under this doctrine, state action affecting interstate and foreign commerce may be limited even where Congress has failed to exert its plenary commerce clause power. (*Barclay's, supra*, 2 Cal.4th at p. 722.) Where the doctrine applies, the courts have adopted various tests "to evaluate state tax schemes to ensure compliance with the inherent demands of the 'unexercised' commerce clause." (*Id.*, at p. 723.) Thus, in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, the court held that a tax which "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State,' . . . does not burden

impermissibly interstate commerce. (Citation.)" (*Barclay's, supra*, 2 Cal.4th at p. 723.) And *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434, held a court must also inquire "'. . . whether the tax, notwithstanding apportionment, creates a substantial risk of international *multiple taxation*, and . . . whether the tax prevents the Federal Government from "speaking with *one voice* when regulating commercial relations with foreign governments." If a state tax contravenes either of these precepts, it is unconstitutional under the . . . Commerce Clause." [Citation.]" (*Barclays, supra*, 2 Cal.4th at p. 723, original italics.)

Alcancorp seeks application of these tests to the tax imposed upon it.

3. *The Dormant Foreign Commerce Clause Doctrine Does Not Apply*

Barclay's, supra, held dormant commerce clause analysis is not appropriate where the federal government has acted in such a manner as to acquiesce in the states' use of worldwide formula apportionment. "In our view, Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind. To paraphrase the *Wardair* [*Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1] opinion, international agreements demonstrate that the federal government has affirmatively acted, rather than remained silent, with respect to the power of the states to employ formula apportionment in so-called foreign parent cases; as a result, this case does not call for dormant foreign commerce clause analysis at all. [Citation.]" (*Barclay's supra*, 2 Cal.4th at p. 733.)

The *Barclay's* court summarized the evidence supporting its conclusion: "[O]ver the past 25 years, senior tax and foreign policy officials of the executive branch have sought to respond to the demands of foreign governments that the states be barred from applying formula apportionment to determine the tax liability of foreign-based multinationals. For much of this period, the chief forum for resulting executive branch initiatives was the Senate, where successive administrations sought to win ratification of a treaty provision barring state use of formula apportionment. But in 1978, with explicit recognition of the 'negative implications' of its act, the Senate *rejected* an income tax convention negotiated by the executive branch with the United Kingdom whose centerpiece was a provision—article 9(4)—prohibiting the states from using formula apportionment in determining the intrastate tax liability of United Kingdom-based multinationals. Only after the ban on state use of formula apportionment was stricken was the administration able to muster the two-thirds majority required for Senate ratification under the treaty clause.

"In addition, numerous bilateral tax treaties between the United States and other nations, although precluding use of formula apportionment by the signatory *national* governments, do not include within that prohibition political subdivisions such as the states. And while such tax treaties *do* include substantial governments within the scope of nondiscrimination provisions, they are *not* included within the prescription that the signatory governments employ an AL/SA [the arm's length/separate accounting alternative to the unitary business/formula apportionment] methodology in taxing local branches of foreign corporations. Similarly, so-called 'Friendship, Commerce and Navigation' treaties—a common form of commercial agreement between the

United States and its trading partners—typically require both the federal and state governments to tax foreign enterprises within their jurisdictions on a 'reasonably allocable or apportionable' basis, a standard which United States drafters viewed as 'intended to cover all the various methods, proportionate or otherwise, by which a reasonable tax base might be determined.' (U.S. State Dept., Standard Draft Treaty of Friendship, Commerce and Navigation, prepared by Charles H. Sullivan (Aug. 1980) pp. 202, 203.)

"Finally, in the wake of Senate rejection of article 9(4) and the decision in *Container* [*Corp. v. Franchise Tax Bd.* (1983)] 463 U.S. 159, upholding California's use of worldwide unitary methods in taxing domestic-parent multinationals, the executive branch scuttled its effort to achieve treaty-imposed curbs on the states' use of worldwide formula apportionment." (*Barclay's, supra*, 2 Cal.4th at pp. 733-734.)

The *Barclay's* court rejected the sort of material claimed by Alcancorp, and by amici curiae on its behalf, to evidence a "clear federal directive" sustaining its dormant foreign commerce clause case. "[R]ather than qualifying as a 'clear federal directive,' these materials, in the context of Congress's persistent refusal to regulate state taxation of multinationals and the Senate's explicit rejection of article 9(4) of the United States-United Kingdom treaty, embody nothing more than executive aspirations of what the federal government's policy in this area *ought* to be." (*Barclay's, supra*, 2 Cal.4th at p. 734, original italics.)

4. *Kraft Foods v. Iowa Dept. of Rev. (1992) 505 U.S. _____ [120 L.Ed.2d 59, 112 S.Ct. 2365] Is Inapposite*

In a supplemental letter brief, Alcancorp cites *Kraft Foods v. Iowa Dept. of Rev.* (1992) 505 U.S. _____ [120 L.Ed.2d 59, 112 S.Ct. 2365], as supportive of its position. In that case, Iowa taxed dividends received from foreign subsidiaries, but not dividends received from domestic subsidiaries, of Kraft General Foods, Inc., a unitary business with operations in the United States and several foreign countries. The United States Supreme Court held this disparate treatment violated the foreign commerce clause. *Kraft Foods* has nothing to do with the question whether the dormant foreign commerce clause precludes imposition by a state of a unitary tax based on the worldwide income of a multinational corporate taxpayer.

DISPOSITION

The judgment is affirmed.

NOT TO BE PUBLISHED

HINZ, *J.*

We concur:

KLEIN, *P. J.*

CROSKEY, *J.*

ORDER OF THE SUPREME COURT OF THE STATE OF CALIFORNIA DENYING PETITION FOR REVIEW

(Filed February 11, 1993)

Second Appellate District,
Division Three, No. B065648
S030387

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

IN BANK

ALCAN ALUMINUM CORPORATION,
Appellant,

v.

FRANCHISE TAX BOARD OF THE
STATE OF CALIFORNIA,
Respondent.

Appellant's petition for review DENIED.

The request for an order directing publication of the opinion is denied.

LUCAS
Chief Justice

STATEMENT OF DECISION OF THE SUPERIOR COURT OF CALIFORNIA FOR THE COUNTY OF LOS ANGELES

(Dated September 30, 1991)

DEPT. 67

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF LOS ANGELES

Date: September 30, 1991 Honorable Kurt J. Lewin Judge	L. Rivas, Deputy Clerk None, (E.R.M.)

(Parties and Counsel checked if present)

C 196 604
ALCAN ALUMINUM CORPORATION

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA

HANCOCK ROTHERT & BUNSHOFT
By: Robert V. Richter
Counsel For Plaintiff

OFFICE OF THE ATTY GENERAL
By: Philip C. Griffin
Counsel For Defendant

[PAGE ONE OF THREE PAGES]

NATURE OF PROCEEDINGS: TRIAL NJ (MISC-AO) TAX LAW INTERPRETATION

ON THIS MATTER, HAVING HERETOFORE BEEN SUBMITTED TO THIS COURT FOR RESOLUTION; THE COURT NOW RULES AS FOLLOWS:

STATEMENT OF DECISION

The constitutionality of California's use of Worldwide Combined Apportionment (WCA) for the determination of the income tax assessed to a California subsidiary of a foreign parent under the Commerce Clause is the issue presented in this action. (Due Process questions are not presented.)

In *Barclays Bank International v. Franchise Tax Board (1990) 225 Cal App 3d 1342*, the District Court of Appeal for the Third District has recently held that the use of WCA in such circumstances is unconstitutional under the so called "dormant" commerce clause analysis of *Japan Line Ltd. v. County of Los Angeles (1979) 441 U.S. 434*. A hearing has been granted by our Supreme Court in *Barclays* and it is currently pending there. Notwithstanding, the parties insist that this Court proceed with the same determination in this action on the theory that the facts to which the parties stipulated somehow present a case specific circumstance differentiating this action, thereby rendering the determination here free from application of the determination to be made by the Supreme Court in *Barclays*. This Court can find nothing in the stipulation of facts which would have that effect.

The Superior Court for Sacramento County has found the use of WCA constitutional for other tax years of plaintiff not at issue here, deciding that *Wardair Canada v. Florida Department of Revenue (1986) 447 US 1*, not *Japan Line* controls, and that there is no need to undertake the dormant commerce clause analysis at all. The Court's analysis was that having failed to preclude the states' use of WCA, Congress has, by clear negative implication, authorized its use by the states. This Court concurs in that decision.

[PAGE TWO OF THREE PAGES] In *Barclays Bank* the Court of Appeal's analysis of the application of *Wardair* focused on five factors urged by the State. The first three, and particularly the fourth, the Court concluded, were too general to glean any negative implication. The Court opined that ". . . trying to assign a specific reason to legislative inaction, we must enter the realm of pure speculation. It is difficult enough trying to ascertain the legislative intent when a statute has been enacted, but trying to find meaning in legislative silence is about as difficult as hearing sound in a vacuum." (*Barclays Bank v. FTB supra 1362.)* But the fifth factor, the United States Senate's failure to ratify the UK-US tax treaty until the offending preclusion of a state's use of WCA was excised left little doubt that Congress was not inclined to impose such restriction. To be sure the Court of Appeal dismissed the significance of the Senate's declination to ratify the treaty observing that "Again, the Board simply reads too much into too little. . . . The treaty with article 9(4) included [the WCA limitation] received a full Senate vote of only 49 to 32, falling 5 votes short of the two thirds majority needed for ratification. . . . In light of these Senate tallies, it is difficult to see a congressional policy permitting states to use WWCR." This Court perceives some significance. The treaty could not find approval until the WCA preclusion was eliminated. Nothing could be clearer. The constitutional requirement of Senate ratification, after all, enjoys equal dignity with the commerce clause itself. Thus, it is hardly relevant to observe that the Senate did not act unanimously. Also this fifth factor ought not to be evaluated standing alone; it sheds light on what in its absence might be accepted about the first four factors: that they are far too general to provide a clear negative implication etc. Taken together the five factors advanced in *Barclays Bank* demonstrate a legislative intent on the part of

Congress not to restrict the states' use of WCA. The same factors are urged here and the presence of the fifth presents an *a fortiori* case to *Wardair* itself.

Plaintiff argues vehemently that the use of WCA, by states has been continuously and vigorously opposed by the executive branch and our various trading partners for years. It seems odd then that Congress has remained smugly silent with no consciousness that its silence would [PAGE THREE OF THREE PAGES] be construed by courts in the manner described in *Wardair*. Can it be that every time the question comes up in any context Congress turns a deaf ear in contemplation that the state or federal courts across the nation will come up with a uniform and correct treatment of disputes regarding the use of WCA? This seems unlikely in the extreme, even if the issue were more thorny or controversial. In any event, state courts ought to be cautious and circumspect before they preempt Congress in matters of national policy.

Again, parenthetically, the facts presented here do not present any case specific circumstances that differentiate this action from *Barclays Bank* or the action in the Sacramento Superior Court, as far as the application of the dormant commerce clause constitutionality analysis versus the reasoning of *Wardair* is concerned, and the determination forthcoming in the Supreme Court will, in all likelihood, be dispositive in this action upon appellate review.

Until the determination in the Supreme Court is made, however, for the reasons set forth above and those set out in defendant's Trial Brief, JUDGMENT IS FOR DEFENDANT.

A COPY OF THIS MINUTE ORDER IS MAILED THIS DATE BY U.S. MAIL ON BOTH APPEARING COUNSEL.

EXCERPTS FROM STIPULATION OF FACTS

Exhibit XXI

[Filed in the Superior Court of the State of California, County of Los Angeles, No. C-196604]

* * *

REASON FOR SHUTDOWN

The Riverside sheet products operation has lost money in every year since 1972, averaging some $900,000 of loss before interest and tax per year during the last four years. (See Appendix 1)

The current Annual Plan predicts a loss of $1.3 million in 1976 and a further loss of $0.7 million next year (after interest but before tax). Sales and booking volumes are running about 10% under plan levels so a substantial additional loss, perhaps up to $0.2 million, can be anticipated. For purposes of this analysis, a continuing pre-tax loss at $1.0-1.5 million per annum is assumed.

Once the plant is shut down and the property and equipment sold, this loss could be eliminated except for Riverside's $150,000 allocated share of the Cleveland office's costs (assuming, conservatively, that the efforts of that office could not be profitably redeployed elsewhere). The estimated annual saving of shutting down Riverside would, therefore, be $850,000 to $1,350,000. Net of depreciation at $360,000 this means an annual cash saving (before tax) of $0.5-1 million.

As of 31 January 1976 the total Riverside operation has $4 million in working capital and another $4 million of net fixed assets for a total capital employed of $8

million (See Appendix 2). Based on an estimated writeoff of $3 million, $5 million can be released for use elsewhere, once the land and buildings are finally sold. Assuming that this $5 million of capital could be employed to earn 10-20% before tax, or $0.5-1 million per year, the Riverside operation would have to generate at least this much cash to justify continuing operations.

Comparing this required profit to the estimated cash loss the gap is then $1-2 million per annum, and this is the principal reason for the proposed shutdown.

ALTERNATIVES

Major Modernization of Riverside Facilities

With a few exceptions, the Riverside equipment is narrow and obsolete. Due to the growth pattern of the facility, the layout is inefficient and the "wide" casting and hot rolling line is too narrow even for double width siding. Any modernization program to increase width capabilities beyond 26" would have to embrace almost the entire plant and would probably cost as much as or more than starting on a green fields basis. The California market would not justify this sort of expenditure.

Move to a New Site

If a sheet mill were to be built from scratch, it is unlikely that California would be the best site due to excessive taxation, stiff pollution controls, and the lack of an adequate market in the area. In any case, the required expenditure would be massive and cannot be contemplated in the forseeable future.

Cold Roll and Coat Only

Various intermediate measures have been reviewed, including shutting down the casting operation only. Unfortunately, none of these make a significant difference partly because the loss of ability to recycle process scrap more or less offsets any overhead savings.

* * *

A17

JOINT REPORT BY INLAND REVENUE AND U.S. TREASURY

UNITARY TAX

REVIEW OF PROGRESS TOWARDS RESOLVING THE PROBLEMS

JOINT REPORT BY INLAND REVENUE AND US TREASURY

December 1991

UNITARY TAX

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CHAPTER 1: INTRODUCTION

1.1 On 22 March 1989 the Financial Secretary to the Treasury in the UK said that the UK Government believed that progress had been made in the two previous years in resolving the unitary tax issue but that problems remained, in particular the fee which companies had to pay (in California) in order not to be subject to worldwide unitary tax. The Government proposed to review the situation jointly with the US Treasury later in the year (1).

1.2. The aim of this review is to assess progress made in modifying the worldwide combined reporting method of unitary taxation and the need for and possibility of further changes which might be made towards meeting the concerns which have been widely expressed about the present Californian State tax laws as they apply to multinational corporations.

1.3. As part of the review a small party of senior United Kingdom Government representatives went to California (which is the only remaining US State with substantial problems for multinational corporations in this area) in April 1990. The prime purpose of the visit was not to lobby but to seek guidance on the situation in California and the possibilities for further changes in the relevant tax provision.

1.4. The UK Parliament has on a number of occasions expressed its hostility to unitary tax. A motion against the tax was signed by 276 Members (nearly half the Members) of the House of Commons (2) in conjunction with a debate on unitary tax which took place in December 1989. In reply, the Financial Secretary made it clear that it was not the intention of the Government to repeal Section 812 of the Income and Corporation Taxes

Act 1988 which provides a retaliatory power which can be triggered to deny the tax credit which would otherwise be payable to US companies in unitary states (3).

1.5. The US authorities have also on a number of occasions expressed opposition to the States' (particularly California's) use of the worldwide combined reporting method of unitary taxation. President Reagan wrote in November 1985 that the Federal Government supported legislation which would effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge requirement") (4). Consistent with that statement, the US Department of Justice filed *amicus curiae* briefs in the case of *Barclays Bank International Ltd v. Franchise Tax Board* detailing the US executive branch policy with respect to California's use of worldwide combined reporting, both in the lower court in September 1986 (5) and in the intermediate appellate court in September 1988 (6). Both briefs presented the argument that California's use of worldwide combined reporting was an unconstitutional interference with the US Federal Government's exclusive authority to conduct foreign affairs and regulate foreign commerce. The US Department of Treasury in August 1989 said that the issue of unitary taxation remained a serious concern to the Treasury Department and to the administration of President Bush (7). On 17 November 1990 the Department of Justice appeared before the Californian Court of Appeal to argue the position of the US administration.

CHAPTER 2: WORLDWIDE UNITARY TAX

2.1. The UK and US Governments, together with a number of Governments of other countries, have opposed the use, by the State of California, of worldwide unitary

tax as a means of assessing the Californian tax liability of multinational companies. This method of tax assessment in the circumstances in which it is applied is contrary to the principles underlying the UK/US tax treaty (and other US tax treaties); is contrary to accepted international practice; is extremely cumbersome and burdensome for multinational companies; can result in double taxation of income earned by multinationals outside the US; and effectively extends the reach of the Californian tax authorities beyond the borders of the US.

Methods of taxing multinational corporations

2.2. All tax jurisdictions in which multinationals operate are faced with the problem of determining the amount of income properly attributable to their jurisdiction. The internationally accepted method, which underlies UK and US tax treaties, is known as the separate accounting or arm's length method. This method applies the principle that each taxing authority should levy tax only on the income arising within the borders of its jurisdiction. To enable jurisdictions to assess corporation tax liability, multinational corporations operating within those jurisdictions are asked to provide separate accounts as if they were independent corporations operating at arm's length from other parts of their business.

2.3. The UK and the US, like other taxing jurisdictions, recognize that multinational companies can, in effect, transfer profits between different taxing jurisdictions, by manipulating the prices at which different constituent parts of their multinational business sell goods or services to each other. Like other taxing authorities, the UK and US deal with this by reserving the right, when assessing the extent of a corporation's earnings

attributable to their jurisdiction, to adjust for tax purposes any transfer prices that have been manipulated, so that they reflect the true market price that would be paid between two independent corporations. The UK/US tax treaties, and other tax treaties, specifically allow the contracting states to make such adjustments.

2.4. Unitary taxation is an alternative way of dealing with the same problem. Instead of taxing the income earned within its taxing jurisdiction, a tax authority using unitary tax assesses the overall income of the group, and then levies tax on a certain proportion of that income. That proportion might be calculated by reference to the company's sales, employment, or assets within one taxing jurisdiction.

2.5. The unitary method is used fairly widely by different states in the US in respect of income earned *within the US.* The method works reasonably well where each of the taxing authorities have broadly similar accounting rules and standards and where the tax regimes and formulae used are compatible. These conditions are moderately well satisfied in varying degrees in the different states within the US.

The effects of the worldwide combined reporting method of unitary taxation

2.6. California has chosen to use the same method in respect of worldwide income. In this context the necessary conditions for the successful use of the unitary method are clearly not fulfilled. Accounting standards in different taxing authorities throughout the world vary very considerably from those within the US. Equally importantly, no country (and certainly not the US

Federal Government) adopts such a method. In these circumstances, the use of worldwide unitary tax has the following defects:

a. a multinational company which has to provide accounts to each taxing authority in whose jurisdictions it operates, according to the accounting standards and tax regime of that authority, then has to recalculate its worldwide earnings according to the accounting standards and tax regime of California. Clearly this is a major and costly burden;

b. in practice, determining what constitutes a unitary multinational group in some cases involves highly questionable and arbitrary assumptions. A multinational company which comes to a different judgment from that of the Californian tax authorities could find itself forced to make the burdensome calculations described at a. above several times over;

c. there is no reason in principle why the proportion of a multinational corporation's earnings which are properly attributable to any one taxing authority should necessarily be the same as the proportion of its sales, employment or assets in that taxing authority. If California uses worldwide unitary and other countries use separate accounting/arm's length, a multinational corporation could well end up being taxed on more than 100% of its worldwide income; it could also be taxed on much less than 100% of its worldwide income. The risk of double taxation or double exemption is clearly very real;

d. a multinational company which had assets, sales and payroll in California, but which happened to make a loss in any one year, could find itself paying tax on non-existent (or even negative) income. Or, alternatively, a multinational corporation which improved its profitability in, say, Australia, by reducing costs in that country, would, under the unitary method, find itself paying more tax in California (which would levy tax on a proportion of any increase in profits) even although there had been no change in the income earned in California;

e. the narrow circumstances which may justify an internationally agreed formulary apportionment of income (for example, for 24-hour, global trading of a single book of securities) do not exist in the majority of cases to which California applies the worldwide combined reporting method of unitary tax.

Review conclusion

2.7. We believe that the worldwide combined reporting method of unitary taxation in the circumstances in which it is applied by California remains contrary to internationally agreed standards embodied in the arm's length principle and that the ultimate goal of the UK and US Governments should remain the elimination of the worldwide combined reporting method of unitary taxation.

CHAPTER 3: MODIFICATIONS IN UNITARY TAX LAW

3.1. Since July 1984 there has been action to reform unitary tax in a number of US States—Oregon, Florida, Massachusetts, Montana, Indiana, Utah, Colorado, New Hampshire, Idaho, North Dakota, California and most recently Alaska—although in some cases the application of unitary tax to foreign-owned corporations is limited and not completely eliminated.

3.2. In 1985 the British Parliament enacted legislation (8) giving the UK Government powers to deny tax credits to multinational corporations based in California, as a form of retaliation against the worldwide combined method of unitary taxation. In the following year the Californian Assembly amended Californian law, so as to enable a multinational corporation to "elect" to be taxed on a "water's edge" basis. The "water's edge" basis was broadly similar to the internationally accepted arm's length/separate accounting method. However, this election required payment of an election fee and the Californian tax authorities had the right to disallow such an election (without refunding the fee) in a number of instances, at their sole discretion. This modification in the Californian law that took place in 1986 persuaded the British Government not to bring into operation the retaliatory powers.

3.3. In 1988 some further modifications were made in California which reduced the election period and rendered the Californian tax authorities' decisions subject to some form of appeal. However, the fee remained in the law. In addition, many of the administrative requirements and potential penalties create conditions under which many multinational corporations say that they are unable to operate. The modifications made, although welcome, do

not, therefore, remove all the concerns about the worldwide combined reporting method of unitary taxation.

3.4. This view is shared by other major industrialised countries. In June 1989, all Member States of the European Community reaffirmed in a letter to the US Secretary of State that the present law in California was unsatisfactory. In reply, Treasury Deputy Secretary Robson confirmed that the US shared the European Community's concerns, and stated that further progress would have to be made in California before the US Government's concerns were met (7). In 1989, Canada, Japan, Australia and Switzerland also made clear their continued opposition to the worldwide combined reporting method of unitary taxation.

Review conclusion

3.5. While California (and some other states) have made some significant modifications in their law in response to international criticism, further progress is required before concerns on this issue can be put to rest. To alleviate the concerns of the interested governments, it would be necessary at least to ensure that the choice between the worldwide combined reporting method and the "water's edge" method of reporting should be unconditional and not subject to any fee, penalty, or subsequent override. In pursuing these goals the Governments of the US and the UK recognize that, under the US federal system, provided the method does not infringe upon a power reserved to the Federal Government or is not otherwise denied a State by the US Constitution, the Federal Government cannot dictate precisely how a State determines income subject to its tax jurisdiction.

CHAPTER 4: THE POSSIBILITY OF FURTHER MODIFICATIONS IN CALIFORNIA'S UNITARY TAX LAW

4.1. Senior UK Government representatives went to Sacramento on 23-27 April 1990 following letters from the UK Chancellor of the Exchequer to US Treasury Secretary Brady and Governor Deukmejian and from Secretary Brady to Governor Deukmejian.

4.2. The purpose of the visit was to enable the UK to contribute to this UK/US review of progress on the unitary tax problem, in particular to assess what further modifications in unitary tax law could realistically be expected from the Californian legislature.

4.3. The delegation was grateful to Governor Deukmejian for setting aside time for a substantial meeting with him. The delegation was also grateful to key Senators and Assemblymen from both the Republican and Democratic parties, Senate/Assembly staffers, Californian tax officials and representatives of both Californian and British business who also made time to see them.

4.4. The administration made it clear that it had done much to meet UK concerns in introducing the modifications it had in 1986 and 1988. The Californian legislature had not been prepared to eliminate the worldwide combined reporting method of taxation completely but had provided for an alternative. Some 700 businesses (out of possibly 5000) had elected for water's edge, of which about 50 were UK companies.

Options for reform in 1990

4.5. There seemed to be two possibilities for legislative changes in 1990.

4.6. *First*, a revenue neutral Bill which failed earlier in the year (proposed by Assemblyman *Brown*) was re-introduced, this time by Assemblyman *Peace* (9). This would have reduced the election period (not to be subject to the worldwide combined reporting method of unitary taxation) from 5 years to 3 years and abolished, with treble damages for wilful default, the provision under which companies can be thrown back on unitary tax (the 'throwback') and the domestic spreadsheet. It did not deal with the election fee (see paragraph 4.7 below).

4.7. The *second* possibility for legislation in 1990 was that abolition of the election fee might feature in a Tax Conformity Bill. It was, however, urged on the UK Government delegation by Senators and Assemblymen that the Californian budget currently faced a $2 billion deficit (although the election fee—some $40 million—was small in this context).

4.8. In the event neither legislative possibility materialised and there was virtually no progress on the legislation front in 1990. The only Bill that did pass (*Alquist*) provided mainly for election fees to be refunded with interest if the Courts finally ruled the worldwide combined reporting method of unitary taxation unconstitutional (10).

Meeting with tax officials

4.9. One point that came out of a very detailed meeting the UK delegation had with Californian tax officials was that the latter confirmed that the throwback provision (see paragraph 4.6 above) would be used only in the most extreme circumstances of wilful default. Although it would of course be preferable to have the throwback abolished altogether, this confirmation was helpful and letters were exchanged to this effect.

The future

4.10. The end of the 1988-1990 two year session of the Californian legislature has now passed and there can be no assurance of any immediate modifications to unitary tax law.

4.11. It is understood that the Auditor General is required to make a review of the spreadsheet and make a preliminary report to the Legislature by 31 December 1991.

4.12. The Californian Franchise Tax Board said that when a Bill was introduced in 1989 to repeal the election fee an analysis indicated that this would cost annually something like $100 million. This loss was made up of two components. First, there was the loss of the fee itself which would have had a $35 million impact. Second, under the Board's assumptions, more people would elect if the fee were eliminated giving rise to a $60-$65 million revenue loss. These estimates were mid-year 1989 and economic circumstances had changed which would, in all likelihood, result in a change in the estimates.

Review conclusion

4.13. It is disappointing that no substantial progress was made on legislation in 1990 and that there can be no assurance of any immediate prospect of legislation. However, the undertaking of the Franchise Tax Board on throwback was helpful.

CHAPTER 5: LITIGATION

5.1. Under the US Constitution the power to conduct foreign affairs and to regulate commerce with foreign nations is reserved to the Federal Government. Where

state or local taxes result in actual international multiple taxation, where such a tax "may impair federal uniformity in an area where federal uniformity is essential", and where such a tax prevents "the Federal Government from 'speaking with one voice' when regulating commercial relations with foreign governments", the tax can be held to be unconstitutional by US courts and may not be collected. See *Japan Line Ltd v County of Los Angeles*, 441 US 434 (1979).

5.2. Early efforts to challenge the constitutionality of the Californian worldwide combined reporting method of unitary taxation under this principle were brought by US-based parent corporations with foreign subsidiaries. They did not succeed. See *Container Corporation of America v Franchise Tax Board*, 463 US 159 (1983). The US Supreme Court, however, in a footnote to its decision in *Container*, explicitly stated that it was not addressing the constitutionality of the worldwide combined reporting method with respect to state taxation of US corporations with foreign parents or of foreign corporations. More recently *Colgate-Palmolive Company Inc*, a US-based parent corporation with foreign subsidiaries, has again challenged the constitutionality of Californian worldwide reporting in the Californian Courts. A decision favourable to Colgate in the Californian Superior Court for the County of Sacramento was reversed in August 1991 by the Californian Court of Appeal which could not find a meaningful distinction between that case and the earlier *Container* decision. The company has since filed a Petition for Hearing in the Californian Supreme Court.

5.3. Cases have been brought by foreign corporations and the US subsidiaries of foreign corporations to address the question left open in the *Container* case. In

Barclays Bank International Ltd v Franchise Tax Board, 275 Cal.Rptr.626 (1990), the Court of Appeal of the State of California on 27 December 1990 affirmed the judgment of the Superior Court of California for the County of Sacramento that the worldwide combined reporting method was unconstitutional under the US Constitution's commerce clause. An appeal against that decision has been made by the Franchise Tax Board to the Californian Supreme Court, which has announced that it will hear the appeal. Either party may appeal against its decision to the United States Supreme Court.

5.4. Unlike in the *Container* case, the US Department of Justice filed an *amicus curiae* brief in *Barclays* both before the trial court as well as in the Californian Court of Appeal. The *amicus* briefs presented the argument that California's use of the worldwide combined reporting method is an unconstitutional interference with the US Federal Government's exclusive authority to conduct foreign affairs and regulate foreign commerce. The Californian Appellate Court in its decision in *Barclays* noted that the filing of the *amicus* brief, the US/UK income tax treaty debate, a letter from President Carter's administration to the State of California, and President Reagan's directive to the Attorney General all demonstrated that the US Federal Government had spoken clearly in opposition to the worldwide combined reporting method. The Appellate Court also found that "every single nation in the industrialised western world has sent letters to the United States Government protesting the use of worldwide combined reporting by American states", and took note of the UK's enactment of retaliatory legislation and the cancellation of several trade missions to the United States. The Court also took note of evidence presented to it by Barclays regarding its incurring a one-time cost of between $6.4 million and

$7.7 milion to establish a system of reporting to comply with the requirements of California's worldwide combined reporting and an additional expense from $2 to $3.8 million each year to maintain the system. The Appeals Court decision in *Barclays* was unanimous.

5.5. The Californian Supreme Court has agreed to hear the appeal against the judgment of the Californian Court of Appeal, and the US Government has prepared an *amicus* brief and sought the Court's permission to file it.

5.6. A preliminary injunction was issued in October 1989, in two suits against the Californian Franchise Tax Board, ordering that about $9.5 million in election fees paid to California (fees paid to elect for the use of the water's edge reporting method) be placed into escrow pending the outcome of constitutionality challenges. See *Nestle Holding Inc v FTB,* California Superior Court, San Francisco County, No.911305 and *Coca Cola Company v. FTB,* California Superior Court, San Francisco County, No.911416.

5.7. In recent Court decisions involving *Alcan Aluminium Corp.* it was held that California's use of the worldwide combined reporting method of unitary taxation was constitutional. However, these cases will be proceeding to appeal.

Review Conclusion

5.8. The recent decision (on 27 December 1990) of the Californian Court of Appeal in the *Barclays* case confirms that a satisfactory solution to the problems faced by UK-based multinationals doing business through subsidiaries in California stands a good chance of being reached by litigation in the US courts, particularly where the US Federal Government makes its views known through the filing of *amicus* briefs.

CHAPTER 6: RECOMMENDATIONS TO THE UK AND US GOVERNMENTS

6.1. Following the recent welcome confirmation in the Californian Appeal Court that the worldwide combined reporting method of unitary taxation, as applied to foreign-based unitary groups, is unconstitutional, *we recommend* that both Governments should continue strongly to support litigation against worldwide unitary tax.

6.2. UK Government statements up to 22 March 1989 (1) have made clear that, in the event of the retaliatory legislation being activated, it would not apply to dividends paid on or before 31 December 1989.

6.3. Pending a settlement of the matter by litigation, *the UK reviewers recommend* that the *United Kingdom* should maintain its retaliatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it; *the US reviewers recommend* that the *United States* should defer taking any action on the declaration of President Reagan in 1985 and subsequent statements by the federal authorities, except as recommended in 6.1., above but that the situation shall be reassessed should the position of the US administration not be upheld in Court.

CHAPTER 7: SUMMARY OF CONCLUSIONS

7.1. The reviewers conclude that

a. the worldwide combined reporting method of unitary taxation remains contrary to internationally agreed standards embodied in the arm's length principle (paragraph 2.7);

b. the ultimate goal of the UK and US Governments should remain the elimination of the worldwide combined reporting method of unitary taxation (paragraph 2.7);

c. while California has made some relaxations in its law in response to international criticism, further progress is required before concerns on this issue can be put to rest. Californian tax law should at least ensure a meaningful choice—unconditional and not subject to any fee, penalty or subsequent override—between the worldwide combined method of reporting and the water's edge method (paragraph 3.5);

d. it is disappointing that no substantial progress was made on legislation in 1990 and there can be no assurance of any immediate prospect of legislation (paragraph 4.13);

e. the recent decision in the Californian Appeal Court (on 27 December 1990 in the Barclays case) that the worldwide combined reporting method of unitary taxation, as applied to foreign-based unitary groups, is unconstitutional confirms that a satisfactory solution stands a good chance of being reached by litigation in the US courts (paragraph 5.8); and

f. both Governments should continue strongly to support litigation against worldwide unitary tax (paragraph 6.1);

7.2. Pending a settlement of the matter by litigation,

a. *the UK reviewers* conclude that *the UK* should maintain its retaliatory legislation on the statute book, giving no further guarantees as to

whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it (paragraph 6.3);

b. *The US reviewers* conclude that *the US* should not take any further action on the declaration of President Reagan in 1985 and subsequent statements by the federal authorities, except as stated in paragraph 7.1.f. above but that the situation shall be reassessed should the position of the US administration not be upheld in Court (paragraph 6.3).

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1. HM Treasury Press Release of 22 March 1989.
2. UK Parliamentary motion of 15 December 1989.
3. Hansard 18 December 1989 Cols 172-178.
4. HM Treasury Press Release of 8 November 1985.
5. Superior Court of the State of California, County of Sacramento, Nos 325059 and 325061.
6. Court of Appeal of the State of California, Third Appellate District 3 Civil C003388 (Consolidated with C003389).
7. US Treasury statement of September 1989.
8. Section 812 Income and Corporation Taxes Act 1988.
9. California Legislature—1989-90 Regular Session—Assembly Bill No. 3333.
10. Senate Bill No 2177.

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No. 92-1751

In The

Supreme Court of the United States

October Term, 1992

ALCAN ALUMINUM CORPORATION,

Petitioner,

v.

FRANCHISE TAX BOARD
OF THE STATE OF CALIFORNIA,

Respondent.

**On Petition For A Writ Of Certiorari
To The Court Of Appeal Of The State Of California
In And For The Second Appellate District**

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the California Courts properly declined to apply a dormant Commerce Clause analysis and properly held that, due to congressional acquiescence, California did not violate the Foreign Commerce Clause by application of worldwide combined reporting to determine the taxable California income of petitioner.

2. Whether the petitioner's trial stipulation, limiting the issues in this case to those involving "one voice" and "multiple taxation" contentions, has limited this Court's jurisdiction, with the result that petitioner is barred from raising questions concerning the four elements of the dormant Commerce Clause analysis set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1974), including whether the tax assessed against petitioner was out of all proportion to its business in California.

3. If a dormant Commerce Clause analysis were appropriate, would California's use of worldwide combined reporting violate the "multiple taxation" test or the dormant portion of the "one voice" test?

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BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JURISDICTION

Petitioner Alcan Aluminum Corporation ("Alcancorp") invokes jurisdiction under 28 U.S.C. § 1257(a). As argued below at pages 12-16, no such jurisdiction exists as to issues beyond the limited issues designated in the portion of the trial stipulation which is reproduced herein in Appendix A at App. 1.

STATUTORY AND CONSTITUTIONAL PROVISIONS

Appendix B hereto is California Revenue and Taxation Code section 25110, regarding California's "water's edge" election.

SUPPLEMENTAL STATEMENT OF THE CASE

This case involves precisely the same primary issue as was presented to this Court in the petition in *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384. Both *Barclays* and *Alcan* involve California's application of worldwide combined reporting ("WWCR") to determine the California taxable income of corporations which are parts of multinational, multicorporate unitary businesses headed by foreign corporations. As long as the California Supreme Court has properly held (in *Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal.4th 708, 829 P.2d 279 (1992)) that the United States Congress has acquiesced in such use of WWCR by the states, there is no need to grant the petition for certiorari in either *Barclays* or *Alcan*. On May 17, 1993, this Court requested the views of the Executive Branch as to the *Barclays* petition.

Respondent Board believes that Alcancorp's statement of the case contains significant omissions which, among other things, go to the issue of whether this Court has jurisdiction over issues which petitioner seeks to have reviewed. Therefore, pursuant to rule 15.1, the Franchise Tax Board provides this Court with this supplemental statement.

Petitioner Alcancorp does not comply with this Court's rule 14(h), which requires a showing in the statement of the case "that the federal question was timely and properly raised so as to give this Court jurisdiction to review the judgment on a writ of certiorari." The reason for this noncompliance is simple: Alcancorp did not properly raise the federal questions involving the dormant Commerce Clause requirements set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

Prior to the commencement of trial in this matter the parties entered into the following stipulation with respect to the issues in this case:

"*ISSUES*

> "For the purposes of this litigation, these parties hereby stipulate that the *only* legal issues before this Court are whether the Board's application of the unitary method of accounting under Section 25101 *et. seq.* of the California Revenue and Taxation Code, and implementing regulations, as applied to the facts in this case violated the Foreign Commerce Clause of the United States Constitution in that such application impermissibly prevents the federal government from speaking with *one voice* or impermissibly gives rise to either the risk of or actual *multiple taxation*. For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or contending that the tax assessed violated the Due Process Clauses of the United States Constitution or the

California Constitution." Appendix A hereto at App. 1 (CT 0062) (emphasis added).

The appellate court decision below found that Alcancorp had waived by stipulation the consideration of any Due Process Clause grounds and specifically the claim that "compliance would impose an undue administrative burden on [Alcan] Aluminum." Pet. App. A-3, n. 2. Neither the trial court, the appellate court nor the California Supreme Court found it necessary to rule upon the effect of the stipulation as to any dormant Commerce Clause issues in this case, because the California courts' application of this Court's decision in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), precluded the need for any dormant Commerce Clause analysis.

This Court need not accept Alcancorp's invitation (Pet. 19-21, 23-24) to delve into the complex facts concerning Alcancorp's Riverside facility, for (1) Alcancorp first says it does not need to rely upon separate accounting to establish alleged distortion under worldwide combined reporting, then proceeds to do so; (2) Alcancorp (at Pet. 17-18, 22-23) is asking this Court to discard "present doctrine," that is, to overrule more than 70 years of precedents, including *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983); (3) Alcancorp's stipulation in the trial court limited the legal issues so as to exclude the distortion issue, thus relieving respondent Board from any burden of presenting any evidence concerning the Riverside facility in order to establish the lack of distortion; and (4) as established below at pages 6-11, Congress' exercise of its Commerce Clause powers in acquiescing in the states' use of worldwide combined reporting has rendered unnecessary any consideration (as

part of a dormant Commerce Clause analysis) of the facts concerning the Riverside facility.

Beyond the stipulated limitation of issues, Alcancorp also has stipulated (App. A hereto at App. 1-2, ¶ 23) that petitioner Alcancorp did not elect to petition the Board for relief under the authority of California Revenue and Taxation Code section 25137, cited by petitioner (Pet. 3-4) as a statutory provision involved in this case.

This Court should also be aware of the actions of Canada in this area. Canada and the United States concluded renegotiations of their bilateral income tax treaty in 1980. Although a letter indicated the Canadians' displeasure with the states' use of worldwide combined reporting ("WWCR"), the renegotiated treaty had no provision restricting such use, because (as recognized by the Canadians) the United States Senate had recently rejected such a proposed limitation. This situation was acknowledged in a note from G. William Miller, Secretary of the Treasury of the United States, to Allan I. MacEachen, Minister of Finance of Canada, and it was agreed that discussions would be reopened on this issue if an acceptable solution were found. Exhibit XXVI-1, attached hereto as Appendix C.

Canada and the United States are members of the Organization for Economic Cooperation and Development (OECD). This organization has drafted a Model Tax Convention for use by its members, wherein arm's length/separate accounting requirements would be applied to both national and subnational taxes. Exhibit XXIII, pp. 24, 28-29. Both Canada and the United States noted exceptions to the Model Treaty clause which would

make the treaty applicable to subnational taxes. Exhibit XXIII, p. 50.

ARGUMENT

I

THE CALIFORNIA COURTS HAVE PROPERLY APPLIED THIS COURT'S *WARDAIR* DECISION IN HOLDING THAT CONGRESSIONAL ACQUIESCENCE IN CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS DETERMINATIVE OF THE COMMERCE CLAUSE ISSUE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS.

Alcan's contentions regarding *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), are based upon a direct misrepresentation of this Court's *Wardair* holding. Alcan's petition contains the following remarkable contention: "In *Wardair*, this Court did not conclude that a dormant Commerce Clause analysis was not appropriate because Congress had acted to permit the tax. Rather, this Court concluded that the case was not appropriate for a dormant Commerce Clause analysis because both of the parties agreed that none of the elements for such an analysis existed. . . . " Pet. 25. This contention finds no basis in the *Wardair* record or opinion.

Directly contrary to petitioner's contention, in *Wardair* this Court rejected dormant Commerce Clause "one voice" arguments on the basis that "in the context of this case we do not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis.

On the contrary, . . . the Federal Government has affirmatively acted, rather than remained silent, with respect to the power of the States to tax [in the challenged manner], and thus . . . the case does not call for dormant Commerce Clause analysis at all." 477 U.S. at 9. "[T]he *law* as it presently stands acquiesces in taxation . . . by political subdivisions of countries." *Id.* at 10 (emphasis in original). "By negative implication . . . the United States has at least acquiesced in state taxation. . . . " *Id.* at 12. "In our view, the facts presented by this case show that *the Federal Government has affirmatively decided to permit the States to impose these . . . taxes.* . . . " *Id.* at 12 (emphasis added).

In *Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal.4th 708, 829 P.2d 279 (1992), the California Supreme Court correctly applied *Wardair* in a manner fully consistent with this Court's February 1993 holding in *Itel Containers International Corp. v. Huddleston*, ___ U.S. ___, 113 S.Ct. 1095, 1105 (1993), the most recent Foreign Commerce Clause tax case. In *Alcan* the California Court of Appeal has followed the California Supreme Court's application of *Wardair* in holding that no dormant Commerce Clause analysis is applicable in this case. Pet. App. A5-A7. The California Supreme Court has denied review. Pet. App. A9. As the Board has argued in opposition to the *Barclays* petition, there is no need for this Court to exercise its jurisdiction to revisit this constitutional area at this time. The California courts have properly applied *Wardair;* both the *Barclays* and the *Alcan* petitions should be denied.

The California Supreme Court's Commerce Clause holding in *Barclay's* applies *Wardair* to conclude that Congress has acted to acquiesce in the state tax practice

which both Barclays and Alcan are challenging. That being so, the California Supreme Court pointedly did not engage in any dormant Commerce Clause analysis. 2 Cal.4th at 742; 829 P.2d at 300. This approach is consistent with this Court's warning in *Wardair*: "It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." 477 U.S. at 12 (emphasis by this Court).[1]

In holding that the *Wardair* rule was applicable to permit California's use of worldwide combined reporting ("WWCR") in the present case, the California Supreme Court placed its primary reliance on the United States/United Kingdom ("US/UK") Treaty which was negotiated and ratified in the 1970's. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668 (Exh. XXV-33). For the first and only time, the federal Executive Branch negotiated a provision for that treaty, article 9(4), which would have explicitly prohibited any state's use of worldwide combined reporting ("WWCR").

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[1] Since the Commerce Clause (U.S. Const. art. I, § 8(3)) gives the power to regulate foreign and interstate commerce to Congress, "any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge." *Western & Southern L.I. Co. v. Bd. of Equalization*, 451 U.S. 648, 653 (1981); see also *Wardair*, 477 U.S. at 12-13.

After much debate, and several votes in the Senate, the treaty was ratified only after that provision was rendered totally inapplicable to the states. 124 Cong. Rec. 18416 (June 22, 1978; Exh. XXIX-3), 19076 (June 27, 1978; Exh. XXIX-6). After more bargaining with the United Kingdom, wherein the United Kingdom exacted other federal tax concessions from the United States, the United Kingdom accepted the treaty with the prohibition of WWCR applicable only to the national governments, not to the states. 31 U.S.T. 5709, 5713. Thus the states' use of WWCR was directly considered as a tax issue during the formulation of the treaty, but the *states'* use of WWCR ultimately was not restricted in the final adoption of the treaty as a part of United States law.

The US/UK Treaty provides a perfect context for the application of the *Wardair* rule: a clear congressional consideration of whether a state tax practice (WWCR) should be permitted, and a final ratification of a treaty which by clear implication permitted the states' application of that tax practice (WWCR). At the time of the final Senate vote, the clear and acknowledged choice before the Senate was either to ratify the US/UK treaty while permitting the states to use WWCR or (since ratification with original article 9(4) had proved impossible) not to ratify the treaty. See 124 Cong. Rec. 18709-12 (June 23, 1978) (statements of Senators Byrd, Church, Javits, Stevens, Sparkman, Cranston and Packwood; Exh. XXIX-4). By more than the required two-thirds vote (82 yeas, 5 nays), the Senate chose to ratify the treaty while permitting (by implication) state use of WWCR. 124 Cong. Rec. 19076 (June 27, 1978; Exh. XXIX-6). In the words of the *Wardair* decision, the Senate has "at least acquiesced" in the use of WWCR

by the states, and under the *Wardair* holding such acquiescence is fully sufficient to establish that the federal government has "affirmatively decided to permit" state use of WWCR. 477 U.S. at 12-13.[2]

The California Supreme Court correctly analogized its holding on the present issue to *Wardair*:

> "The parallels between this evidence of 'governmental silence' or refusal to act and that regarded as decisive in *Wardair, supra,* 477 U.S. 1, seems to us both evident and compelling. As in *Wardair,* an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals), 'the *law* as it presently stands acquiesces' in the states' continued use of that practice. As in *Wardair,* the 'negative implications' of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And

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[2] It is significant in the present case that, in negotiating the current U.S./Canada Income Tax Treaty (which also has no restriction upon the states' use of WWCR), the government of Canada recognized that the Senate had rejected proposed treaty limitations of the states' use of WWCR. Exh. XXVI-1, attached hereto as Appendix C. As this Court stated in *Wardair,* referring to another U.S.-Canadian agreement, "in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation." 477 U.S. at 12.

> certainly, in the circumstances of Senate consideration detailed above, the explicit removal of 'political subdivisions' from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, 'must be understood as representing a policy choice by the contracting parties.' (*Wardair, supra*, 477 U.S. at p. 11." *Barclay's Bank*, 2 Cal.4th at 735, 829 P.2d at 295-96 (emphasis in original; footnote omitted).

Recognizing that formula apportionment such as WWCR has been a matter of international interest from at least the mid-1950's (2 Cal.4th at 737-38, 829 P.2d at 297-98), and noting that indications of such federal acquiescence also were to be found in the history of other bilateral income tax treaties (*id.* at 736-39, 829 P.2d at 296-98) and in legislative histories of congressional bills (*id.* at 736, 829 P.2d at 296), the California Supreme Court applied *Wardair* to hold that (1) California's application of WWCR in this case has been permitted by Congress under its Commerce Clause powers, and (2) since Congress has acted to permit such application, no dormant Commerce Clause analysis was necessary. As the California Supreme Court properly applied *Wardair* in its *Barclay's* decision, once it is determined that Congress has acquiesced in the type of state taxation which is being challenged, there is absolutely no need for the courts to engage in any *dormant* Commerce Clause analysis. Therefore, in this case there is no necessity for this Court to review petitioner's claim that California's application of WWCR resulted in a violation of any of the elements of dormant Commerce Clause analysis.

II

PETITIONER'S STIPULATION LIMITING THE ISSUES TO BE LITIGATED IN THIS CASE BARS PETITIONER FROM PRESENTING FOR THIS COURT'S CONSIDERATION THE FOUR ELEMENTS OF DORMANT COMMERCE CLAUSE ANALYSIS SET FORTH IN *COMPLETE AUTO TRANSIT v. BRADY.*

Jurisdiction of this Court to review state court decisions is conferred by 28 U.S.C. § 1257. "It is well settled that this Court will not review a final judgment of a state court unless 'the record as a whole shows either expressly or by clear implication that the federal claim was adequately presented in the state system.' " *Bd. of Dirs. of Rotary Int'l v. Rotary Club*, 481 U.S. 537, 550 (1987). The issue of whether a federal question was sufficiently raised is itself ultimately a question to be decided by this Court. *Street v. New York*, 394 U.S. 576, 583 (1969). A litigant, however, must follow state procedures in raising the federal question. *In re Lamkin*, 355 U.S. 59 (1957).

The trial stipulation in this case (quoted above at pages 3-4) provides that the constitutional issues raised involve *only* the "one voice" and "multiple tax" elements of Foreign Commerce Clause analysis. Dormant Interstate Commerce Clause analysis as described in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), has four elements. These elements are the question of nexus, the question of fair apportionment, the question of discrimination, and the question of relationship between the services provided and the benefits received. With respect to dormant *Foreign* Commerce Clause analysis, this Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), indicated that in addition to those four elements,

two additional elements are also involved: enhanced risk of multiple taxation and impairment of the ability of the federal government to speak with one voice.[3] In the present case, the stipulation specifically limits the issues involved to the questions of "one voice" and "multiple taxation." This stipulation does not mention any of the four *Complete Auto* elements.[4]

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[3] The "one voice" issue has both nondormant and dormant Commerce Clause components: if Congress has acted so as to either permit or prohibit the type of state tax at issue, the one voice has spoken and all necessary Commerce Clause analysis is concluded; if the one voice has not spoken, then there is a dormant Commerce Clause context in which the courts must determine whether the challenged state tax implicates foreign policy issues which must be left to the Federal Government. See *Wardair*, 477 U.S. at 12-13, 7-9; *Container*, 463 U.S. at 194.

[4] Alcancorp's stipulation as to the issues also provides that "Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business. . . . " Appendix A hereto. Under *Container*, 463 U.S. at 169-71, 180-85, and as further clarified as to the discrimination element in *Trinova Corp. v. Michigan Dept. of Treasury*, ___ U.S. ___, 111 S.Ct. 818, 835 (1991), it is clear that Alcan's acceptance of the Board's determination that a unitary business exists necessarily leads to a conclusion in favor of California's use of worldwide combined reporting with respect to all four of the elements involved in a *Complete Auto* examination of the tax. It is no wonder that Alcancorp would like this Court to find that the reasoning in *Container* is "flawed" (Pet. 22) and would like to see a change in this Court's "present doctrine" (Pet. 18), even though such a suggestion is directly contrary to this Court's very recent confirmation that "the unitary business principle of taxation . . . does a better job of accounting for 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied-Signal, Inc. v. Director, Div. of Taxation*, ___ U.S. ___, 112 S.Ct. 2251, 2261 (1992).

California follows the "theory of trial" doctrine with respect to its appellate practice. The "theory of trial" doctrine is based upon the rationale that a party should " . . . not [be] permitted to change his position and adopt a new and different theory on appeal. To permit him to do so would not only be unfair to the trial court, but manifestly unjust to the opposing litigant." *Ernst v. Searle*, 218 Cal. 233, 240-41, 22 P.2d 715, 718 (1933). A corollary to this rule is that ". . . stipulations as to legal issues . . . entered into in the trial court must be adhered to upon appeal." *Carmichael v. Reitz*, 17 Cal.App.3d 958, 969, 95 Cal.Rptr. 381, 386 (1971). The California Supreme Court has recently confirmed the California procedural rule that the California courts "will respect a stipulation limiting the issues in a case." *Title Ins. Co. v. State Bd. of Equalization*, 4 Cal.4th 715, 733, 842 P.2d 121, 132 (1992). Under the general "theory of trial" doctrine, and under the more specific procedural rule respecting stipulations which limit issues, in this case the California courts properly would not consider petitioner's assertion of dormant Commerce Clause grounds other than "one voice" and "multiple taxation."

Petitioner in its filings with the California courts did not cite to or discuss *Complete Auto* except belatedly in its filing of a supplemental brief with the Court of Appeal after this Court's decision in *Kraft General Foods, Inc. v. Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992), and in its petition and reply in the California Supreme Court. The Board recognizes that petitioner has throughout the proceeding peppered its arguments with allusions to nexus, fair apportionment and discrimination concerns

despite its stipulation as to the issues. The Board, however, has objected throughout the proceedings to petitioner's efforts to inject these dormant Commerce Clause considerations and Due Process Clause considerations into this case. Because the California Courts have found that all dormant Commerce Clause analysis is inappropriate under this Court's ruling in *Wardair Canada, Inc. v. Florida*, 477 U.S. 1 (1986), they have not found it necessary to address petitioner's efforts to broaden this case beyond the issues stated in the stipulation.[5]

State procedural rules which restrict the raising of federal questions to the early stages in a case have been recognized as valid exercises of state power. See *McKesson Corp. v. Florida Alcohol & Tobacco Div.*, 496 U.S. 18, 44-45 (1990); *Williams v. Georgia*, 349 U.S. 375, 382-383 (1955).[6] In this case, the California courts have not needed to give a direct ruling that Alcancorp's stipulation barred it from arguing the *Complete Auto Transit* dormant Commerce Clause elements. However, this Court has held with respect to silence on a federal question that "it

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[5] An exception should be noted in that the California appellate court specifically noted that Due Process Clause issues were not present in the case as a result of the stipulation. Pet. App. A-3, n. 2.

[6] In this Court's 1990 opinion in *Franchise Tax Bd. of Cal. v. Alcan Aluminium*, 493 U.S. 331, 340-41 (1990), this Court's denial of Tax Injunction Act relief to Alcancorp's parent corporation was based in part on an assurance that the subsidiaries had the capability of raising all potential Commerce Clause arguments in the California Courts. In making that assurance in oral argument, counsel for the Board was careful to point out that such capability would be subject to procedural defenses regularly provided by California law. Tr. of 11/1/89 Oral Arg. 6.

will be assumed that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary." *Street v. New York*, 394 U.S. 576, 582 (1969). The same rationale is applicable in the instant case.

In discussing a supporting rationale for the jurisdictional bar when the federal issue was not ruled upon or considered by the state courts, this Court has recognized, "Questions not raised below are those on which the record is very likely to be inadequate, since it certainly was not compiled with those questions in mind." *Cardinale v. Louisiana*, 394 U.S. 437, 439 (1969). If ever there were a situation in which such a rationale had application, it must be in the circumstances of a case tried solely on stipulated facts with a limiting stipulation as to the issues involved. Respondent Board tried and defended this case under petitioner Alcancorp's stipulation as to the issues presented. To allow consideration of issues upon which respondent offered no evidence because the opposing litigant had stipulated them out of the case would be a grave injustice.

III

EVEN IF A DORMANT COMMERCE CLAUSE ANALYSIS WERE TO BE APPLIED, THERE WOULD BE NO VIOLATION OF THE MULTIPLE TAXATION OR "ONE VOICE" ELEMENTS OF THE *JAPAN LINE* TEST.

Alcan Aluminum Corporation seeks to raise a number of dormant Commerce Clause concerns in its petition. As set forth in argument I above, respondent

Board believes that the California courts correctly concluded that this Court's decision in *Wardair, supra,* renders unnecessary any consideration of any dormant Commerce Clause arguments. In addition, as argued in argument II above, petitioner's stipulation bars it from raising any dormant Commerce Clause issues beyond "one voice" and "multiple taxation" in this lawsuit. Therefore, respondent Board will address only the "one voice" and "multiple tax" elements of dormant Commerce Clause analysis in this portion of the argument. (By doing so, the Board does not intend to waive any right to argue that the other elements of a dormant Commerce Clause analysis would preclude Alcancorp's challenge to California's use of worldwide combined report accounting.)

As noted above at page 13 n. 4, Alcancorp's stipulation removing any issue that it was not engaged in a unitary business as determined by the Board (and any issue that Alcancorp was denied due process) necessarily leads under *Container* to a conclusion that California's use of WWCR was nondistortive. Under these circumstances, and if *Wardair* were somehow inapplicable, the only dormant Commerce Clause issues in this case would be whether this *"proper and fair method of taxation,"* because of its differences from other tax accounting methods, either (1) violates the "enhanced risk of multiple taxation" standard, or (2) " 'impair[s] federal uniformity in an area where federal uniformity is essential.' " *Container,* 463 U.S. at 185-86 (emphasis added).

A. Multiple Taxation

This Court in *Container* analyzed the multiple taxation element of *Japan Line*'s dormant Commerce Clause analysis in the context of the California tax here at issue. The Court stated:

> "In *Japan Line*, we said that '[e]ven a slight overlapping of tax – a problem that might be deemed *de minimis* in a domestic context – assumes importance when sensitive matters of foreign relations and national sovereignty are concerned.' [Citations omitted.] If we were to take that statement as an absolute prohibition on state-induced double taxation in the international context, then our analysis here would be at an end. But, in fact, such an absolute rule is no more appropriate here than it was in *Japan Line* itself. . . . Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State." 463 U.S. at 189.

This Court's conclusion that, " . . . it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation" (*id.* at 193), is just as applicable in the present context. There is nothing in this Court's *Container* reasoning with respect to double taxation that is dependent on the domicile of the parent company. The law with respect to this issue is settled and is dispositive of the multiple tax issue in this case.

B. One Voice

In *Container* this Court set forth the standard to be applied in a dormant Foreign Commerce Clause "one voice" analysis. The Court stated:

> "In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' " 463 U.S. at 194.

In the truly dormant Commerce Clause portion of the "one voice" analysis (a pre-emption analysis falls outside of a dormant Commerce Clause analysis, see above at note 3) in *Container*, this Court determined that California's use of worldwide combined reporting with respect to a unitary business headed by a domestic corporation did not "impair federal uniformity in an area where federal uniformity is *essential*" by "implicat[ing] foreign policy issues which *must* be left to the Federal Government. . . . " *Id.* at 193, 194 (emphasis added). In making that determination, this Court applied the test of whether California's application of worldwide combined reporting in the *Container* context might "justifiably lead to significant foreign retaliation." *Id.* at 194. Under the *Container* facts, the Court found that three factors (lack of automatic asymmetry, entity upon whom the tax is imposed, and the amount of the tax burden) weighed strongly against there being any such *justifiable* retaliation. Except for the fact that the taxpayer corporation in the present case has a foreign parent corporation, those

same distinctions apply with equal force in this case. In addition, other factors establish that no retaliation could be justified.

A disagreement between a foreign country and this Court as to the fairness and propriety of worldwide combined reporting cannot form the basis for a "justifiable" retaliation, no matter how predictable retaliation might be given the foreign country's historical opposition to WWCR. This Court has held that the California tax at issue is a "proper and fair method of taxation" (463 U.S. at 184) which "reflect[s] a reasonable sense of how income is generated" (*id.* at 169-170) and which avoids the "basic theoretical weaknesses" of arm's length/separate accounting methods (*id.* at 181). In light of these conclusions of this Court, retaliation based on contrary views cannot be "justifiable."

An independent reason why retaliation is not justified in this case is the formulation of the U.S./Canada tax treaty now in force. Canada tried, and failed, to outlaw the states' use of worldwide combined reporting with respect to Canadian companies. Canada's acceptance of this fact is reflected in diplomatic notes exchanged between Canada and the United States. Exhibit XXVI-1 (App. C). Just as retaliation by the United Kingdom would be a direct violation of the US/UK treaty,[7]

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[7] The Executive Branch has explicitly recognized that the United Kingdom's threatened implementation of a retaliatory measure would clearly violate the US/UK treaty; Executive Branch testimony to Congress includes the following statement regarding the United Kingdom's retaliatory measure:

retaliation now by Canada would be inconsistent with the bargained-for U.S./Canada Treaty and thus clearly not justifiable.

Also, Canada has a federal system of government which is similar to that of the United States. This similarity, and Canada's concern for the sovereign rights of its provinces, led it to express a reservation (just as the United States did) to the OECD Model Treaty provisions which include subnational taxes within its reach. Exhibit XXIII, p. 50. Such separation and protection of the sovereign powers of its own subnational units of government would be inconsistent with a generalized retaliation by Canada against United States-related corporations because of California's method of tax accounting.

Finally, in 1986 California enacted legislation, operative in 1988, which allows both foreign and domestic based businesses, upon payment of a fee, to elect out of the use of WWCR and use a "water's-edge" method. In general, the "water's edge" method determines California taxable income of corporations which are part of multinational enterprises by applying formulary apportionment only to unitary activities within the "water's edge." Arm's length/separate accounting is used in analyzing transactions between corporations within the "water's edge" group and their foreign affiliates. Stip.

"We believe that its existence is inconsistent with the U.S.-U.K. bilateral income tax treaty to the extent its threatened use causes U.S. taxpayers to refrain from claiming benefits under the treaty. *Its actual implementation would be a clear violation of the treaty.*" Exh. XXX-9, p. 12 (emphasis added).

¶ 169, App. A hereto at App. 2, ¶ 169; Cal. Revenue and Taxation Code § 25110 (see Appendix B hereto). Since California has changed its law to provide an option to avoid WWCR, no foreign retaliation now for pre-1988 use of WWCR could be justifiable.

CONCLUSION

For the reasons given above, it is respectfully submitted that the petition for writ of certiorari should be denied. If this Court should decide to grant the petition, it is respectfully submitted that the issues to be argued should be limited solely to whether a dormant Commerce Clause analysis has been rendered unnecessary by congressional acquiescence in the states' use of WWCR, and, if any dormant Commerce Clause analysis is necessary, whether the "one voice" and "multiple taxation" elements of dormant Commerce Clause analysis would render California's actions impermissible.

Dated: June 2, 1993.

Respectfully submitted,

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APPENDIX A

EXCERPTS FROM STIPULATION OF FACTS

(Filed in the Superior Court of the State of California, County of Los Angeles, No. C-196604)

p. 2 (CT 0062):

ISSUES

For the purposes of this litigation, these parties hereby stipulate that the only legal issues before this Court are whether the Board's application of the unitary method of accounting under Section 25101 *et seq.* of the California Revenue and Taxation Code, and implementing regulations, as applied to the facts in this case violated the Foreign Commerce Clause of the United States Constitution in that such application impermissibly prevents the federal government from speaking with one voice or impermissibly gives rise to either the risk of or actual multiple taxation. For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or contending that the tax assessed violated the Due Process Clauses of the United States Constitution or the California Constitution.

pp. 9-10 (CT 0069-0070):

23. Alcancorp has paid the additional assessments and has pursued administrative remedies with the Board regarding the Board assessments for the years 1965 through 1974, and has instituted suits for refund as authorized by California law. Alcancorp did not elect to

petition the Board for relief under the provisions of California Revenue and Taxation Code Section 25137. (See Exhibit XIX-1 for a copy of the original Los Angeles complaint and Exhibit XIX-2 for a copy of the original Sacramento complaint.)

p. 66 (CT 0126):

169. The California Legislature has passed and the Governor has signed various bills allowing taxpayers to elect to not use the worldwide combined report method. California Senate Bill 85 (Alquist) signed by Governor Deukmejian September 5, 1986, an act to add Chapter 1.9 (commencing with Section 15365), Chapter 6 (commencing with Section 15397), and Chapter 7 (commencing with Section 15398) to Part 6.7 of Division 3 of, and to add Article 12 (commencing with Section 16429.30) to Chapter 2 of Part 2 of Division 4 of, Title 2 of, the Government Code, to amend Sections 24274, 24344, 24348, 24667, and 24668 of, to amend and renumber Section 25110 of, to add Sections 24411 and 24670 to, and to add and repeal Article 1.5 (commencing with Section 25110) of Chapter 17 of Part II of Division 2 of, the Revenue and Taxation Code, relating to taxation is attached hereto as Exhibit XXXVII.

APPENDIX B

STATUTORY PROVISIONS

CALIFORNIA REVENUE AND TAXATION CODE

Section 25110 (water's edge election):

(a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer which makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code, other than corporations making an election under Section 936 of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Infernal Revenue Code.

(3) Any corporation, regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(4) Banks and corporations which are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of such a bank or corporation derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.

(6) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(7) Any affiliated bank or corporation which is a "controlled foreign corporation", as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income of and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income", of that bank or corporation for that income year

and the denominator of which is the "earnings and profits" of that bank or corporation for that income year, as defined in Section 964 of the Internal Revenue Code.

(8) (A) The income and factors of the above-enumerated banks and corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted. (B) The income and factors of a bank or corporation which is not described in paragraphs (1) to (4) inclusive, and (6) and which is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(b) For purpose of this article and Section 24411:

(1) An "Affiliated bank or corporation" means a bank or corporation which is related to a bank or corporation, required to file under this part, because of any of the following:

(A) It owns directly or indirectly more than 50 percent of the voting stock of the bank or a corporation required to file under this part.

(b) More than 50 percent of its voting stock is owned directly or indirectly by a bank or corporation required to file under this part.

(c) More than 50 percent of voting stock of both it and the bank or corporation required to file under this part is owned or controlled directly or indirectly by any bank or person (as defined in Section 7701(a)(1) of the Internal Revenue Code).

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporation individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 26423 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends, received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A bank or corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by

members of the unitary group and which is engaged in the same general line of business.

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or which sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations which set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.

APPENDIX C

STIPULATION EXHIBIT XXVI-1

September 26, 1980

The Honorable
Alan J. MacEachen
Deputy Prime Minister and
Minister of Finance of Canada

Sir:

I have the honor to acknowledge receipt of your note of September 26, 1980, which reads as follows:

"I have the honour to refer to the Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed today, and to confirm certain understandings reached between the two Governments with respect to the Convention.

1. In French, the term "societe" also means "corporation" within the meaning of Canadian law.

2. The competent authorities of each of the Contracting States shall review the procedures and requirements for an organization of the other Contracting State to establish its status as a religious, scientific, literary, educational or charitable organization entitled to exemption under paragraph 1 of Article XXI (Exempt Organizations), or as an eligible recipient of the charitable contributions or gifts referred to in paragraphs 5 and 6 of Article XXI, with a view to avoiding duplicate application by such organizations to the administering agencies of both Contracting States.

If a Contacting State determines that the other Contracting State maintains procedures to determine such

status and rules for qualification that are compatible with such procedures and rules of the first-mentioned Contracting State, it is contemplated that such first-mentioned Contracting State shall accept the certification of the administering agency of the other Contracting State as to such status for the purpose of making the necessary determinations under paragraphs 1, 5 and 6 of Article XXI.

It is further agreed that the term "family," as used in paragraphs 5 and 6 of Article XXI, means an individual's brothers and sisters (whether by whole or half-blood, or by adoption), spouse, ancestors, lineal descendants and adopted descendants.

3. It is the position of Canada that the so-called "unitary apportionment" method used by certain states of the United States to allocate income to United States offices or subsidiaries of Canadian companies results in inequitable taxation and imposes excessive administrative burdens on Canadian companies doing business in those states. Under that method the profit of a Canadian company on its United States business is not determined on the basis of arm's-length relations but is derived from a formula taking account of the income of the Canadian company and its world-wide subsidiaries as well as the assets, payroll and sales of all such companies. For a Canadian multinational company with many subsidiaries in different countries to have to submit its books and records for all of these companies to a state of the United States imposes a costly burden. It is understood that the Senate of the United States has not consented to any limitation on the taxing jurisdiction of the states by a treaty and that a provision which would have restricted

the use of unitary apportionment in the case of United Kingdom corporations was recently rejected by the Senate. Canada continues to be concerned about this issue as it affects Canadian multinationals. If an acceptable position on this subject can be devised, the United States agrees to reopen discussions with Canada on this subject.

4. I have the honour to propose to you that the present Note and your reply thereto shall constitute an agreement between our two Governments on these matters."

I confirm these understandings on behalf of the Government of the United States of America. These understandings constitute an agreement between our two Governments on this matter, which will enter into force on the date of entry into force of the Convention between the Government of the United States of America and the Government of Canada with Respect to Taxes on Income and on Capital which was signed today.

Accept, Sir, the renewed assurances of my highest consideration.

(Signed by: G. William Miller
Secretary of the Treasury)

Supreme Court, U.S.
FILED
JUN 2 1993
OFFICE OF THE CLERK

No. 92-1751

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

ALCAN ALUMINUM CORPORATION,
Petitioner,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California in and for the Second Appellate District

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BRIEF OF THE GOVERNMENT OF CANADA AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether the application of the corporate income apportionment formula, known as worldwide combined reporting, to domestic corporations with foreign parents violates the Foreign Commerce Clause of the United States Constitution, Article 1, Section 8, Clause 3.

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IN THE

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ALCAN ALUMINUM CORPORATION,
Petitioner,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California in and for the Second Appellate District

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BRIEF OF THE GOVERNMENT OF CANADA AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE GOVERNMENT OF CANADA

Petitioner, Alcan Aluminum Corporation ("Alcan"), is a member of a multinational corporate group based in Montreal, Quebec, Canada and a U.S. subsidiary of a Canadian corporation, Alcan Aluminium Limited ("Limited"). The Alcan Petition makes it clear that Limited and its non-U.S. subsidiaries have no permanent establishments in California, yet they are adversely affected by Respondent Franchise Tax Board's ("FTB") application of worldwide combined reporting ("WWCR") to Alcan. Other multinational corporate groups based in Canada and elsewhere outside the United States, with which California has no jurisdictional link whatsoever, are similarly

affected by FTB's use of WWCR.[1] Thus, the taxation at issue in this Petition is different from the domestic taxation this Court has previously considered.[2] The taxation here is in reality of international rather than local concern. Canada shares that concern.

In the interest of preserving commerce between Canada and the United States,[3] eliminating the serious adverse consequences of WWCR for Canadian corporations, and ending the disruption to the international taxation framework caused by WWCR, Canada hereby submits this brief *amicus curiae* in support of Petitioner.[4]

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[1] See, for example, *amicus curiae* brief of the Government of the United Kingdom and *amici curiae* brief of the twelve Member States of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, filed in this Court in support of Petitioner in *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384 (April 22, 1993).

[2] *Container Corp. of America v. Franchise Tax Bd.* 463 U.S. 159 (1983).

[3] Canada and the United States have the largest bilateral trade and economic relationship in the world. In 1992, two-way trade was almost $184 (U.S.) billion. Canada accounted for approximately 21% of all U.S. exports, and more than 77% of Canada's exports went to the U.S. In that year, imports by Canada from California exceeded $5 (U.S.) billion, and Canadian exports to California were almost $5 (U.S.) billion. *Statistics Canada*, International Trade Division, 1993.

At the end of 1992, total United States investment in Canada amounted to $198.8 (U.S.) billion, representing about 47% of all foreign investment in Canada. Of this total, U.S. direct investment in Canada was approximately $68.7 (U.S.) billion, representing about 64% of all foreign direct investment in Canada. Canadian direct investment in the United States at the end of 1992 was more than $45.5 (U.S.) billion. *Statistics Canada*, Catalogue 67202, "Canada's International Investment Position," 1992.

[4] Petitioner and Respondent have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

STATEMENT

Since 1983, when this Court reserved determination of the issue presented,[5] Alcan and Limited have been seeking relief in both Federal and state courts in the United States. From 1984 until 1990, Limited was involved in litigation with FTB over its use of WWCR in United States Federal Courts: the District Court for the Northern District of Illinois; the Court of Appeals for the Seventh Circuit; and this Supreme Court of the United States, which held that while Limited had standing as the sole stockholder of Alcan to challenge WWCR on foreign commerce clause grounds, the Tax Injunction Act barred the action.[6] In accordance with this Court's decision, Alcan resumed the litigation in California: in the Los Angeles County Superior Court; the Second Appellate District, Division Three of the Court of Appeal of the State of California; and the California Supreme Court, which denied its Petition for review in December 1992.

Canada and the other main trading partners of the United States, including the United Kingdom and the Member States of the European Communities, filed *amici curiae* briefs supporting Limited and Alcan. Other countries and their corporations have been involved in similar searches for a judicial resolution.[7] Canada and other members of the international community have continued to register by diplomatic channels their objection to FTB's intrusion into the international tax framework.[8] The con-

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[5] *Container Corp., supra* at 189, n. 26 and 195, n. 32.

[6] *Franchise Tax Board of California v. Alcan Aluminium, Ltd.*, 483 U.S. 331 (1990).

[7] For example, *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384 (1993); *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (CA9), cert. denied, 464 U.S. 1012 (1983); *EMI Ltd. v. Bennett*, 738 F.2d 994 (CA9), cert. denied, 469 U.S. 1073 (1984).

[8] September 26, 1980 Exchange of Letters between the Honourable Allan J. MacEachen, Deputy Prime Minister and Minister of Fi-

nance of Canada, and the Honourable G. William Miller, Secretary of the Treasury of the United States (September 26, 1980), with reference to The Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, 1984 C.T.S. 15, p. 64, I Tax Treaties (CCH) 1317MB; Diplomatic Note No. 692 from Canada to the United States, December 22, 1981; Diplomatic Note No. 245 from Canada to the United States, May 10, 1982; Diplomatic Note No. 283 from Canada to the United States, June 14, 1982; Letter of his Excellency, Allan Gotlieb, Canadian Ambassador to the United States, to the Honourable Donald T. Regan, United States Secretary of the Treasury, August 11, 1983; Letter of the Honourable Marc Lalonde, Minister of Finance of Canada, to the Honourable Donald T. Regan, Secretary of the Treasury of the United States, August 11, 1983; Letter of his Excellency, Allan Gotlieb, Canadian Ambassador to the United States, to the Honourable Donald T. Regan, United States Secretary of the Treasury, August 23, 1983; Letter of the Right Honourable Pierre Elliott Trudeau, Prime Minister of Canada, to his Excellency, Ronald Reagan, President of the United States, September 24, 1983; Diplomatic Note No. 481 from Canada to the United States, September 28, 1983; Diplomatic Note No. 338 from Canada to the United States, June 17, 1985; Letter of his Excellency, Allan Gotlieb, Canadian Ambassador to the United States, to the United States Secretary of State, Secretary of the Treasury, and Attorney General, September 30, 1987.

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troversy has been partially responsible for stalling some bilateral tax treaty negotiations with the United States.[9]

The "water's edge election" statute California enacted in 1986 and that became effective in 1988[10] has not eliminated the problems caused by FTB's continued reliance upon WWCR. Though corporations can now "elect" whether FTB can apply WWCR to them, they must pay a substantial fee for the "privilege" and contract with the FTB to be bound by that election for a rolling ten year period. Under this contract, corporations must also agree to accept burdensome information requirements to be imposed solely at the discretion of FTB. The contract also provides for a penalty—the reimposition of WWCR without any refund of the election fee—which

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from Embassy of Australia, November 7, 1983; Demarche No. 461.20-LJ/hu from Embassy of Switzerland, November 15, 1983; Demarche from the Republic of Germany, November 28, 1983; Demarche EA-14533 from Embassy of the Netherlands, December 21, 1983; Demarche from Belgium, President European Communities, supported by the Member States of the European Communities, the European Commission, and the Embassies of Australia, Japan, Canada, and Switzerland, January 1, 1984; Demarche from Embassy of Belgium, January 25, 1984; Aide-Memoire from Government of Japan, June 6, 1984; Demarche from Ireland, President European Communities, on behalf of the Member States of the European Communities, December 20, 1984; Demarche from the Commission of the European Communities and the Embassy of Luxembourg, August 8, 1985; Demarche from the Member States of the European Communities and the Commission of the European Communities, August 30, 1985; Letter of his Excellency, Julian Santamaria, Ambassador of Spain, on behalf of the Member States of the European Communities, to the Honourable James A. Baker III, United States Secretary of State, June 30, 1989; Demarche from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities, July 22, 1992.

[9] January 30, 1986 letter of United States Secretary of State George P. Shultz to the Governor of California. (Relevant text of letter set out in Footnote 26, *infra.*)

[10] California Revenue and Taxation Code § 25110.

can be imposed by the FTB without any provision for judicial review.

United States Assistant Secretary of the Treasury for Tax Policy J. Roger Mentz explained in testimony before the United States Senate Committee on Finance that the Federal Government had: "a number of serious policy concerns with the California legislation" including:

> In our view, a foreign corporation's ability to avoid being taxed by a state on its foreign income should not be conditioned on payment of a substantial election fee.[11]

ARGUMENT

I. THE APPLICATION OF WORLDWIDE COMBINED REPORTING TO DOMESTIC SUBSIDIARIES OF FOREIGN CORPORATIONS CREATES AN ENHANCED RISK OF MULTIPLE TAXATION.

The internationally accepted norm for allocating income for tax purposes is arm's length separate accounting ("AL/SA"). Under AL/SA, the income of each member of a corporate group is computed by separate accounting on the basis that each member of the group must deal with the other as if it was a wholly separate entity owned by unrelated interests. This method follows model conventions for the avoidance of double taxation developed by the Organization for Economic Cooperation and Development ("OECD")[12] and the United Nations, both of which expressly rejected formula

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[11] *Hearings on S. 1974 before the Senate Committee on Finance Subcommittee on Taxation and Debt Management*, 99th Cong., 2d Sess. (September 29, 1986), (statement of J. Roger Mentz, Assistant Secretary of the Treasury for Tax Policy).

[12] The members of the OECD are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States of America.

apportionment in favor of arm's length allocation.[13] Furthermore, Canada notes with satisfaction that the United States Supreme Court has recognized there is a "serious divergence in the taxing schemes adopted by California and the foreign taxing authorities" and that the method preferred by the United States Government and adopted by "foreign taxing authorities is consistent with accepted international practice." [14]

The principles of AL/SA have been adopted by the nations of the world in their double taxation treaties.[15] As a result, a considerable degree of harmonization between

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[13] United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 5(8), 7(2), 9(1), U.N. Doc. ST/WSA/102 (1980); Report of the OECD Comm. on Fiscal Affairs, Model Double Taxation Convention on Income and on Capital, arts. 5(7), 7(2), 9(1) (1977).

[14] *Container Corp., supra* at 187.

[15] The use of arm's length separate accounting and the requirement of a permanent establishment are contained in all of the 58 bilateral income tax treaties to which Canada is currently a party, including the Convention between Canada and the United States of America with Respect to Taxes on Income and Capital signed at Washington on September 26, 1980, 1984 C.T.S. 15, T.I.A.S. No. 11087.

The requirement of the use of AL/SA has been contained in every tax treaty to which the United States has been a party since the first such treaty, which was signed with France April 27, 1932. 164 LTS 211, TS 885, 49 Stat. 3145, Article IV.

All of the U.S. treaties for the prevention of double taxation contain an absolute prohibition on U.S. taxation of the profits of a foreign corporation that does not have a permanent establishment in the U.S. Article VII of the United States-Canada Income Tax Convention exemplifies this prohibition:

> The business profits of a resident of a Contracting State shall be taxable only in that state unless the resident carries on business in the other Contracting State through a permanent establishment situated therein. If the resident carries on, or has carried on, business as aforesaid, the business profits of the resident may be taxed in the other State but only on so much of them as is attributable to that permanent establishment.

their bilateral tax conventions has been achieved, to the benefit of taxpayers and national governments. This framework of understanding and cooperation on taxation matters has contributed to the significant growth of trade and investment since World War II.

Applying WWCR, FTB considers separate foreign and domestic corporations part of a multicorporate group as one, and subjects all their worldwide income to tax as one "unitary" corporation, regardless of whether it is taxable under the Internal Revenue Code or applicable treaty, or has been attributed to and taxed in foreign jurisdictions. The group's combined income is apportioned between California and the rest of the world on the basis of an arbitrary formula composed of the ratio of payroll, sales, and property of the group in California compared to the world.

Canada notes that the United States Supreme Court has acknowledged the double taxation that results from the serious divergence between WWCR and the international norm.[16] It is difficult to imagine a more "serious divergence" from the international taxation framework than WWCR. To Canada's knowledge, of all the countries in the world and their political subdivisions, only California and North Dakota apply WWCR to foreign based multicorporate groups.[17] Double taxation occurs because WWCR employs entirely different principles for deciding where income is earned. The double taxation produced can only be resolved if WWCR is required to give way to AL/SA.[18]

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[16] *Container Corp., supra* at 187.

[17] Montana applies WWCR only to domestic based multicorporate groups.

[18] Any multiple taxation or undertaxation that occurs from any differences in the allocation of income and expenses among tax jurisdictions employing AL/SA, being those of inconsistent applications of the same principle, can be eliminated and resolved through international negotiation and double taxation conventions.

Double taxation is also the consequence of the severe distortions that ensue when diverse economic conditions throughout the world are incorporated into the WWCR formula.[19] WWCR assumes that a dollar spent on payroll or property, or a dollar of sales made in one tax jurisdiction produces roughly the same amount of taxable income as a dollar so spent, or sale made, in another tax jurisdiction. Common sense and realities of the marketplace defeat that assumption.

It would be equally challenging to present a more extreme example of double taxation than the Petitioner describes.[20] When FTB, through the use of WWCR, combined the loss of Alcan with the income of Limited and its non-U.S. subsidiaries, the FTB levied assessments totalling $1,720,615.94 (U.S.).[21] Clearly income not earned in California by Alcan was subjected to California's taxation. Obviously, that income was earned outside of California's taxing jurisdiction, and just as plainly, subject to taxation where it was actually earned.

II. THE USE OF WWCR PREVENTS THE UNITED STATES GOVERNMENT FROM SPEAKING WITH ONE VOICE WHEN REGULATING COMMERCIAL RELATIONS WITH FOREIGN GOVERNMENTS.

The use of WWCR contradicts the policy of the United States Government. The *amicus curiae* brief of

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[19] *State Taxation of Foreign Source Income: Hearings on H.R. 5076 before the House Committee on Ways and Means, 96th Cong., 2d Sess. 7 (1980)*, (statement of Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy).

[20] Petition for Writ of Certiorari, 19-22.

[21] *Alcan Aluminum Corporation v. Franchise Tax Board of the State of California*, No. B065648 (Court of Appeal of the State of California, Second Appellate District, Division Three), unpublished opinion p. 2 (Nov. 11, 1992). Petition for Writ of Certiorari, A2.

the United States filed below succinctly states the United States Government's position:

> It is the position of the United States that California's worldwide unitary income allocation method of taxation may not constitutionally be applied to the taxpayer (plaintiff-appellant) without impairing the ability of the United States to speak with one voice in conducting and controlling foreign relations and international commerce.[22]

As discussed above, the use of AL/SA has been required by every tax treaty to which the United States has been a party since the first such treaty signed with France on April 27, 1932. The United States Senate has ratified all of those treaties and the United States Congress included that requirement in Internal Revenue Code § 482,[23] the predecessor to which was first enacted in the Revenue Act of 1928.

The disruption to the United States' ability to speak with one voice, which results from it and the rest of the world having one international corporate taxation system and California having another incompatible one, is evident:

> A failure to bring this development to a halt and to eliminate the international incidence of unitary taxation might lead the international community to conclude that the United States has ceased to speak with one voice and thus is no longer contributing to the international tax order toward which the United

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[22] Brief *Amicus Curiae* of the United States in Support of Plaintiff and Appellant Alcan Aluminum Corporation, *Alcan Aluminum Corporation v. Franchise Tax Board of the State of California*, Court of Appeal of the State of California, Second Appellate District, p. 2, (April 1992).

[23] 26 U.S.C. § 482.

States, Germany and other nations have worked for so many years.[24]

If left to stand, the decision of the California courts below will affirm the impairment of the United States to speak with one voice. Canada and other trading partners of the United States would not be able to rely upon the United States Government's official declarations of national policy in the area of foreign commerce if such policy were to be ultimately determined by a state court's interpretation of the "inaction" of Congress.

No approval of FTB's use of WWCR can be inferred from the fact that bilateral tax treaties in general, and the tax treaties to which Canada and the United States are a party specifically, do not explicitly prohibit political subdivisions from using WWCR.[25] In International Law, Sovereign States have the capacity to become parties to treaties, not their political subdivisions, be they provinces or states. Historically, bilateral conventions have not set standards for the taxes of political subdivisions, because it has been considered that once a treaty has been entered into, in conformity with an international norm, a political subdivision would not presume to devise another method of taxing international income earned outside its jurisdiction by members of multicorporate groups with no permanent establishment there. As discussed above, such other methods occur nowhere outside of the two states of the United States.

The repeated diplomatic expressions of disapproval of WWCR by the treaty partners of the United States contradict any claim that their treaties with the United States

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[24] Memorandum to the United States Department of the Treasury on the Issue of State Taxation by Worldwide Combination and Formula Apportionment "Unitary Taxation," Federal Republic of Germany, Federal Ministry of Finance, p. 5, (Nov. 28, 1983).

[25] Many of the bilateral tax treaties to which the United States and Canada are a party predate the use of WWCR.

somehow "approve" of its use.[26] Numerous examples of the official expressions of disapproval by Canada and other trading partners of the United States are detailed above. Most recently, the British Chancellor of the Exchequer the Right Honourable Norman Lamont announced that the British Government will have to take retaliatory measures in relation to United States-based companies if there is not a satisfactory resolution of the problems caused by the FTB's use of WWCR by the end of 1993.[27]

Canada, like the other main trading partners of the United States, questions the utility and effectiveness of double taxation conventions with the United States when the application of WWCR by a few states, such as California, clearly frustrates the spirit of the convention and impairs the benefits accruing to Canadian nationals conducting commercial activities in the territory of the United States. Most recently, Canada and other coun-

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[26] United States Secretary of State George P. Shultz in his January 30, 1986 letter to the Governor of California summarized the international expressions of offense over the use of WWCR:

> The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.
>
> Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. treaty for U.S. corporations operating in worldwide unitary states.

Secretary of State Shultz was referring to Section 54 of and Schedule 13 to the Finance Act of 1985—now reenacted as Section 812-815 of the Income and Corporations Taxes Act 1988.

[27] House of Commons Official Report, *Parliamentary Debates* (Hansard), Column 528 of the Official Record of 13 May, 1993, Vol. 224, No. 178.

tries have pointed out that determination of the issue presented here will influence their future bilateral treaty negotiations with the United States.[28]

CONCLUSION

Canada is concerned about FTB's continued use of WWCR because, *inter alia*: Canada-based multicorporate groups are adversely affected; double taxation of their income results; WWCR conflicts with the international framework established to avoid such double taxation; and the ability to rely upon the United States Government to speak with one voice for the nation is put in doubt. Numerous other countries have expressed these same concerns.

It behooves this Court as the appropriate agency of the United States to resolve as it can now do the legal issue of the validity of the application of WWCR to domestic corporations with foreign parents. Canada notes that all the elements that this Court has specified as necessary to determine the issue are present in this case: (1) the serious divergence between WWCR and the established tax framework presents an automatic asymmetry; (2) the incidence of the tax falls on a domestic corporation owned by a Canada parent corporation; and (3) the concern over FTB's use of WWCR is international, not local.

In addition, this case presents a clear example of the double taxation that inherently results from the application of WWCR. There also can be no doubt that United States foreign policy is impaired. The *amicus curiae* briefs submitted by the United States at every level below in

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[28] *Amici curiae* brief of the twelve Member States of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, filed in support of Petitioner, p. 2., *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384 (1993).

this case and *Barclays Bank, PLC v. Franchise Tax Board,* No. 92-1384 confirm it. The major trading partners of the United States have most recently expressed, in briefs filed with this Court, their concern over the effect of that impairment upon their future economic and commercial relations with the United States.[29]

The Government of Canada asks that Petitioner's Petition for a Writ of Certiorari be granted.

Respectfully submitted,

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[29] See, for example: *amicus curiae* brief of the Government of the United Kingdom and *amici curiae* brief of the twelve Member States of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, filed in support of Petitioner in *Barclays Bank PLC v. Franchise Tax Board,* No. 92-1384 (1993).

(4)

No. 92-1751

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

ALCAN ALUMINUM CORPORATION,
Petitioner,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Respondent.

On Petition for Writ of Certiorari to the Court of Appeal of the State of California In and For the Second Appellate District

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association, which was organized in 1969 as an advisory committee on the Council of State Chambers of Commerce. COST, which was separately incorporated January 1, 1992, has a membership of more than 380 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve

and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Virtually all COST member companies are engaged in business in the State of California, either directly or through subsidiary operations, and are subject to that State's corporate income tax. COST member companies include a substantial number of organizations that are owned by non-U.S. corporations. A significant number of COST member companies are engaged in business in jurisdictions outside the United States and would be subject to retaliatory actions by such countries should worldwide combined reporting be upheld. Therefore, COST clearly has an interest in the instant case, in which the constitutionality of California's imposition of worldwide reporting on foreign parent unitary groups is at issue.[1]

SUMMARY OF ARGUMENT

The State of California's imposition of worldwide combined reporting has been the subject of Foreign Commerce Clause challenges for over twenty years. Although this reporting method, as applied to domestic parent groups was upheld in *Container Corporation of America*

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[1] Under worldwide combined reporting, the method used by California to apportion the income of multinational corporations, the entire income of a worldwide unitary group is apportioned using a fraction which represents the ratio of in-state payroll, property and sales to worldwide payroll property and sales, to determine the income attributable to California. In contrast to the method employed by California, the United States and its international trading partners use the arm's length separate accounting method to allocate income of multinational corporations. Under this method, each corporate member of an affiliated group which comprises the multinational enterprise is a separate taxpayer. The affiliated members are treated as if they were unrelated separate entities for the purpose of determining income from intercompany transactions. The separate accounting theory eliminates the need for any formula division of income among different taxing jurisdictions because multinational income is allocated to each member corporation in accordance with its own transactions.

v. Franchise Tax Board, 463 U.S. 159 (1983), this Court explicitly reserved the specific question at issue in this case, that is, whether worldwide combined reporting as imposed on a foreign parent unitary group violates the Foreign Commerce Clause. 463 U.S. at 189, n.26.

Not only does this case raise the issue reserved by the Court in *Container,* it also presents certain facts that the Court emphasized as missing in *Container.* Unlike *Container,* the tax at issue in this case falls on a unitary group with a foreign parent. *Id.* at 195. Most importantly, this Court no longer has to guess at the risk of retaliation by foreign nations, 463 U.S. at 194, as the offense to our foreign trading partners has been clearly expressed by the United Kingdom's enactment of retaliatory legislation. Thus, ten years after *Container,* the Court is finally presented with a fully developed opportunity to answer the question left open in that case.

Because of the implications of the decision of the California Court of Appeal for the Federal Government's ability to conduct foreign policy; the importance of the issue to the states and to a large number of taxpayers, as well as foreign governments; and in consideration of the long period that this issue has been pending, this Court should grant the petitioner's petition for writ of certiorari.

ARGUMENT

CERTIORARI SHOULD BE GRANTED IN THIS CASE BECAUSE THE FEDERAL GOVERNMENT'S ABILITY TO FORMULATE FOREIGN TRADE POLICY IS IMPAIRED BY CALIFORNIA'S IMPOSITION OF WORLDWIDE COMBINED REPORTING ON FOREIGN PARENT UNITARY GROUPS.

Article I, § 8, cl. 3 of the United States Constitution reserves to Congress the power to regulate commerce with foreign nations and among the states. This Clause, "by its own force created an area of trade free from interference by the States" and "even without implementing legislation by Congress is a limitation upon the power of the States." *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 328 (1977). With regard to foreign commerce, the "constitutional prohibition against state taxation . . . is broader than the protection afforded to interstate commerce . . . because matters of concern to the entire Nation are implicated." *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* —— U.S. ——, 112 S. Ct. 2365, ——, 60 U.S.L.W. 4582, 4584 (1992). Because foreign commerce is afforded broader protection, this Court stated in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), that "[f]oreign commerce is preeminently a matter of national concern," 441 U.S. 448, and held that a state tax violates the Foreign Commerce Clause if it "impair[s] federal uniformity in an area where federal uniformity is essential." 441 U.S. at 448.

Three months ago in *Itel Containers International Corp. v. Huddleston,* 61 U.S.L.W. 4173 (Feb. 23, 1993), this Court reaffirmed that when a state tax is being scrutinized under the Foreign Commerce Clause, the tax must be analyzed under the tests set forth in *Japan Line,* as well as the four-prong test set forth in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).[2] Quoting

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[2] In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977), this Court set forth the following four-prong test for

Japan Line, supra at 451, this Court state in *Itel, supra* at 4176, that

> a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and second, whether the tax prevents the Federal government from "speaking with one voice when regulating commercial relations with foreign governments."

In *Container Corporation of America v. Francise Tax Board,* 463 U.S. 159 (1983), this Court elaborated on the "one voice" requirement of *Japan Line,* stating that where a state tax is at variance with federal policy, the "one voice" standard is violated if the state tax "*either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." 463 U.S. at 194 (emphasis in original). In determining whether the "one voice" test is violated due to the implication of foreign policy, this Court stated that "[t]he most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.*

In *Container,* this Court felt that it could not determine when a foreign nation might be offended by a state tax policy. *Id.* However, one no longer has to speculate about whether foreign trading partners are so offended by worldwide combined reporting that retaliatory actions might be taken. In 1985, the United Kingdom enacted retaliatory legislation that would deny certain tax credits provided by the United States/United Kingdom Income Tax Treaty [3] to United States corporations doing business

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determining whether a state tax comports with the interstate commerce clause: 1) whether there is a substantial nexus between the state and the activity it seeks to tax; 2) whether the tax is fairly apportioned to the taxing state; 3) whether the tax discriminates against interstate commerce; and 4) whether the tax is fairly related to the services provided by the state.

[3] Under the United States/United Kingdom Income Tax Treaty, a United States corporation receives a refund of certain amounts of

in a state imposing worldwide combined reporting. Finance Act of 1985, Section 54, recodified as Section 812 of the Income and Corporation Taxes Act of 1988. Although the United Kingdom has not yet triggered this provision, as this Court recognized in Japan Line, "[t]he risk of retaliation . . . under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole." 441 U.S. at 450.[4] As this Court also stated in *Japan Line*, "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453.[5]

California's deviation from the internationally accepted allocation method also imposes enormous accounting and

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taxes withheld by a United Kingdom payor on dividends paid by that payor. United States corporations are entitled to this refund for taxes paid on dividends received from U.K. subsidiaries and from investments of at least 10% in unrelated U.K. corporations.

[4] In Unitary Tax: Review of Progress Towards Resolving the Problems, a Joint Report by Inland Revenue and the U.S. Treasury, issued in December, 1991, the United Kingdom reviewers concluded that, pending settlement of the issue of the constitutionality of worldwide combined reporting through litigation, the United Kingdom "should maintain its retaliatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it." ¶ 7.2.a.

[5] Any retaliatory action taken by the United Kingdom "of necessity would be felt by the Nation as a whole," *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 453 (1979), because the impact of its retaliatory statute is not limited to California based corporations. The United Kingdom may, at its discretion, consider a company to have a "qualifying presence" within California if it is subject to tax by the State or has a relatively small property, payroll or sales in California. Income and Corporations Taxes Act of 1988, Sections 812(1) and (3). Therefore, a corporation doing business in every state except California and receiving dividends from investments in U.K. corporations could face a greatly increased U.K. tax burden if it is simply affiliated with a corporation with minimal contacts with California.

administrative burdens on taxpayers with affiliates in both California and foreign countries. Since the foreign corporations that are required to be included in a worldwide unitary group are not taxable in the United States and may not have any transactions with any U.S. entity, they have no reason to maintain books and records on a U.S. basis or on a basis reflecting the State's three-factor (property, payroll and sales) formula. Thus, the use of the worldwide combined reporting system requires a totally separate record keeping system solely for California tax purposes.

The worldwide combined reporting method requires a foreign corporation to prepare and maintain records in United States currency. The required conversion of financial data of each foreign subsidiary to United States dollars must take into account many different exchange rates and sharp fluctuations of value. Such computations are a costly and burdensome administrative expense necessitated by California's deviation from international and federal tax standards. The costs of complying with the administrative requirements of California's tax system may, in fact, exceed any tax which is ultimately due the State.

The administrative compliance burden of worldwide combined reporting in the face of an otherwise uniform standard is prohibitive and creates the very barrier to international trade that the foreign commerce clause is intended to prevent. It also presents a formidable barrier to interstate commerce when a foreign-owned entity doing business in a non-worldwide combined reporting state, *e.g.*, Illinois, starts to do business in California. That entity, if related to any foreign entities through a foreign parent, would subject each company in the entire group to onerous record keeping requirements solely to satisfy California's tax return filing requirements. California is the only jurisdiction repudiating arm's length/separate ac-

counting by requiring all multistate and multinational corporation to use worldwide combined reporting.[6]

Taxpayers have challenged California's use of worldwide combination of Foreign Commerce Clause grounds since the State began enforcing this form of taxation. This Foreign Commerce issue is of such importance to international trade and the retaliatory threat to domestic corporations so immediate that the Court must grant *certiorari* in this case.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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Dated: June 2, 1993

[6] Taxpayers in California must pay a fee in order to file on a "water's edge" basis, thereby excluding foreign corporations from the unitary group.